STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
	:	
Rulemaking concerning the	:	**02-0581**
establishment of mandatory provisions	:	
for money pool agreements involving	:	
public utilities and incumbent local	:	
exchange carriers.	:	

ORDER

DATED: November 25, 2003

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By the Commission:

I. BACKGROUND

On September 11, 2002, the Illinois Commerce Commission ("Commission") entered an order authorizing a proceeding to establish rules to set standards for money pool agreements entered into by Illinois public utilities and by telecommunications carriers providing non-competitive services. The Commission issued the order based on a report from the Staff of the Financial Analysis Division of the Illinois Commerce Commission dated August 12, 2002 ("Staff Report"). The Staff Report alleged that, based on an examination and comparison of the currently executed and proposed money pool agreements of Illinois public utilities and incumbent local exchange carriers, current law, current and proposed regulations, and recent events in the energy and telecommunications industries, most existing money pool agreements insufficiently protect the interests of those regulated entities and their customers. As described in the Staff Report, "money pool agreement" ("MPAs") refers to any affiliated interest agreement that provides a mechanism for borrowing or lending monies among affiliated parties. Money pool agreements are established to coordinate and provide for the short-term cash requirements of the participating parties.

Following the Commission's initiating Order, Staff filed its Verified Initial Comments and its proposed draft of 83 Ill. Adm. Code 340 on January 21, 2003 ("Staff Initial Comments" and "Proposed Rule"). On February 4, 2003, the following parties filed written Comments in response to Staff's Verified Initial Comments and its proposed money pool agreement rule: Union Electric Company and Central Illinois Public Service Company (collectively, "Ameren"), Citizens Telecommunications Company of Illinois ("CTC"), Commonwealth Edison Company ("ComEd"), Illinois Bell Telephone Company ("SBC"), National Association of Water Companies ("NAWC"), Northern Illinois Gas Company ("Nicor") and Verizon North Inc. and Verizon South Inc. (collectively, "Verizon") (collectively, company "Initial Comments"). Staff filed its Verified Rebuttal Comments and another proposed draft of 83 Ill. Adm. Code 340 on February 18, 2003

("Staff Rebuttal Comments"). Concurrently, CTC, Nicor, and Verizon filed additional comments on February 18, 2003. (Company "Additional Comments"). On March 5, 2003, the following parties filed written comments in response to Staff's Rebuttal Comments and its proposed money pool agreement rule: Ameren, CTC, ComEd, Nicor, Utilities Inc. ("UI"), and Verizon (collectively, company "Rebuttal Comments"). On April 4 and April 9, 2003 Staff filed its Verified Surrebuttal Comments and Revised Proposed Rule ("Staff Surrebuttal Comments").

A proposed order was served on all parties. Briefs on Exceptions were filed by Staff, NICOR, Verizon, and Citizens. Replies to Exceptions were filed by Staff and Citizens. All briefs on exceptions and replies were duly considered.

II. GENERAL COMMENTS

A. Purpose and Benefits

1. Staff Initial Comments

Staff asserts that money pool agreements should contain provisions to protect the utility from loss of funds and the subsidization of affiliates through unfavorable terms governing the borrowing and lending of funds. From the standpoint of regulators, money pool agreements should convenience the public, as required under Section 7-102(C) of the Act. Thus, at a minimum, participation in a money pool agreement should do no harm to the utility, and perhaps even benefit the utility. In Docket 95-0615, in analyzing Commonwealth Edison Company's affiliated interest agreement with Unicom, the Commission concluded "if the evidence indicates the benefits to ratepayers are reasonably likely to exceed the costs or harms to ratepayers, then approval of the Agreement would be appropriate."[3] Applying the foregoing test as the appropriate measure of the public convenience standard, Staff believes that money pool agreements should (1) ensure that the utility has access to short-term funds, through either borrowing new funds or recalling utility funds lent to affiliates; (2) provide that the utility pays a fair rate on amounts borrowed and receives a fair return on amounts lent; and (3) ensure that funds the utility lends on a short term basis are temporarily not needed for utility purposes and are adequately secured. Staff Report at 3.

Staff believes that to ensure access to short-term capital, money pool agreements should (1) permit the utility to access short-term funds from sources outside the money pool in instances in which either the money pool has inadequate funds for the utility's needs or the cost of money pool funds exceeds that which the utility would incur if it borrowed funds in the market or from unaffiliated entities; (2) permit the utility to withdraw its funds on demand; and (3) ensure that those funds are available for withdrawal when the utility needs them. Thus, money pools should provide some form of credit security and a standby source of liquidity. A provision that ensures that the utility pays no more in interest to its affiliates than it would when borrowing in the open market would protect the utility from unfairly subsidizing affiliates. That objective would be furthered if a provision entitled utilities to receive interest income commensurate with the risk of the companies in the pool. Further, utilities should be allowed to go outside the pool to borrow or invest funds whenever that is in the best interests of the utility. *Id.*

2. Verizon Initial Comments

Verizon generally comments on the Proposed Rule as unnecessary, overreaching, harmful, and as proposed, may prevent smaller utilities from participating in money pools. Verizon further asserts that since the capital markets are creative, a “cookie cutter” approach to regulate money pooling is far too restrictive, and will preclude Illinois utilities from participation in advantageous money pool arrangements that may arise in the future. Thus, Verizon believes, a rigid rule will deprive Illinois of the significant benefits to consumers and utility shareholders that other states will reap through developments in money pooling.

3. Staff Rebuttal Comments

Staff states that it recognizes that restricting the use of money pool agreements has costs, but when properly administered, money pool agreements can reduce both administrative and interest costs for participants. However, Staff informs, money pool agreements are not an exception to the financial rule that no benefit can be obtained without paying a price. Staff explains that to gain the benefits associated with money pool agreements, risks are incurred; namely, utility surplus funds are not diversified and a utility’s insulation and independence from unregulated, nonutility affiliates is reduced. The task is to find the proper balance between risk and return (i.e., benefit).

Staff notes that Verizon correctly recognizes that the capital markets are creative, but Staff feels Verizon fails to recognize that creativity is neither inherently good nor bad. Rather, Staff continues, creativity is a means the value of which wholly depends on the end toward which it is directed. Staff notes several examples: 1) In the last two years, Enron had utility subsidiaries lend it funds they borrowed through their credit facilities, declare bankruptcy, and leave the utilities on the hook for the loans; 2) AES Corporation had Cilcorp borrow funds that AES needed to purchase Cilcorp, sending Cilcorp subsidiary Central Illinois Light Company’s credit rating plummeting from “AA-“ to “BBB-“; 3) Dynegy Inc. created senior claims to power plants it obtained from Illinois Power Company at the expense of the latter’s creditworthiness. Staff not only acknowledges that the proposed rule may limit creativity, but Staff intends that it would do so. This is the risk and return trade-off referred to previously. That is, some efficiency that money pools have the potential to provide would be sacrificed in exchange for increased safety for utility capital.

4. Verizon Rebuttal Comments

Verizon argues that a process is already in place that provides the Commission with the ability to balance risk and return. This process, Verizon contends, includes a review of affiliated contracts, has been in place for many years, works extremely well, and does not need to be fixed.

Verizon maintains that the Proposed Rule is an ineffective reaction to the events mentioned by the Staff in its reply comments (i.e., Enron, Central Illinois Light Company, and Dynegy). Verizon argues that these events are related to long-term securities transactions and not to MPAs, which address short-term affiliate investing and borrowing transactions. Verizon further argues that the Proposed Rule would not have prevented the recent unfortunate events from happening, as they all were related to long-term financing transactions of the utilities' "parent" company, which are not subject to this rule. Verizon argues that the Proposed Rule would not prevent an unscrupulous management team from entering illegal, unethical financing transactions, or making misrepresentations. Verizon therefore questions why it is necessary to "limit creativity" considering that the current process provides for Commission approval and simultaneously provides the flexibility to enter creative and legitimate MPAs.

5. Ameren Rebuttal Comments

Ameren argues that Staff has not presented any evidence that cash management programs such as Ameren's money pool have resulted in a loss of utility funds. Ameren argues that the record contains no evidence that there is an undue risk when a utility lends short-term funds to its affiliate, especially if that affiliate is another utility or an approved service company as is the case with the Ameren utility money pool. Ameren asserts that while these examples cited by Staff may represent an abuse or improper structuring of internal borrowing arrangements or evidence of imprudent intercompany corporate finance decisions, the examples are unrelated to any money pool arrangement.

Ameren has structured its utility money pool arrangement in such a manner as to prevent the transfer of cash from its regulated businesses to its unregulated businesses. Imposing lofty credit requirements on the borrowers within Ameren's utility money pool, regulated utilities and a PUHCA services company which derives the majority of its cash flow from the regulated utilities it serves, is unnecessary, creates additional costs and makes it far more difficult for Ameren to make efficient use of its limited committed bank credit resources. Furthermore, such restrictive borrowing requirements may result in liquidity problems for these utilities--certainly not the intent of the Proposed Rule.

6. Staff Surrebuttal Comments

In response to CTC's accusation, that Staff's proposed rule precludes certain utilities from participating in a money pool arrangement. CTC Rebuttal Comments at 2. Staff asserts that, contrary to CTC's claim, the proposed rule does not preclude certain utilities from participating in a money pool arrangement. The proposed rule allows utilities to borrow from affiliates provided the requirements set forth in Section 340.30 are met. Staff notes that no party to this proceeding has taken issue with the Section 340.30 requirements. The Section 340.40 requirements allow affiliates to borrow from utilities provided that the affiliate possesses sufficient backup liquidity sources to repay the short-term loan. Furthermore, Staff added two options for an affiliate to become eligible to borrow from a utility: (1) the affiliate is a utility; and (2) the affiliate is a service company and the utility does not issue indebtedness to unaffiliated entities and (a) the utility is classified as small or (b) the utility demonstrates that the benefits associated with relying on an affiliate to provide the utility with capital exceed the risks associated with a decrease in the utility's financial independence and the affiliate is a medium-grade credit issuer.

Staff believes that the proposed rule enhances the Commission process for reviewing money pool agreements by laying out the minimum requirements for short-term loans between affiliates. The requirements for short-term loans to utilities from affiliates, as outlined in Section 340.30, prevent utilities from subsidizing affiliates through unreasonably high interest charges. The requirements for short-term loans to affiliates from utilities, as outlined in Section 340.40, enhance the safety of utility funds by ensuring that the funds utilities lend to affiliates will be repaid when due. Section 340.50 provides guidelines for investing utility surplus funds, thereby ensuring that money pool funds will be safe and accessible to its participants. The reporting requirements provided in Section 340.60 allow the Commission to monitor money pool agreement transactions and further ensure compliance with the rule. Finally, the establishment of minimum standards would streamline the process for reviewing money pool agreements by reducing the number of issues for litigation.

Lastly, Staff opposes Ameren, CTC, and Verizon's assertion that Staff has wrongly applied a "one size fits all" approach to money pool agreements involving Illinois utilities. Ameren Rebuttal Comments at 2; CTC Rebuttal Comments at 10; Verizon Rebuttal Comments at 2-3. This complaint is unjustified given that of the fourteen parties that filed petitions to intervene that this rule would affect, only three, Ameren, CTC and Verizon, argue that the rule is unnecessary and harmful; and (2) the rule takes into account different money pool arrangements, including Ameren's unusual structure in which Union Electric Company borrows outside the money pool on behalf of other members of the Ameren money pool agreement.

7. Commission Review and Conclusion

Recent unethical financial transactions, and current economic conditions have prompted the Commission to reexamine the rules regarding money pool agreements. In doing so, the Commission initiated a process to establish rules that would: 1) enhance the safety of utility money deposited with or loaned, advanced or temporally transferred to affiliates; 2) ensure that any utility money lent, advanced, or transferred to affiliates does not hinder the utility from carrying out its duty to provide safe, adequate, reliable, and least-cost utility service; 3) ensure that utilities do not unjustly subsidize affiliates; and 4) provide a high degree of assurance that a borrower would be able to repay the funds borrowed from the utility when needed.

The Commission notes that money pools are not without risk. The objective of this rule making procedure is not only to eliminate risk, but also to preserve the benefits. Following, the parties exchanged, in several rounds, comments and opinions, until they achieved a balanced rule that offset the risks and maintained the benefits of MPAs. The Commission adopts 83 Ill. Adm. Code 340 ("New Rule"), and notes that the New Rule minimizes the risks associated with money pool agreements, while maximizing the benefits by restricting the participants and transactions in a money pool.

The Commission rejects Verizon's objections that it prefers to maintain the status quo, because Verizon appreciates the flexibility the Commission currently has in approving MPAs individually with no standard, and argues that anything more structured would be inflexible and unresponsive to the changing business environment. Part 340 has undergone a lengthy Commission hearing process, where all parties submitted at least two rounds of Comments. The process resulted in a set of standards that takes into account most concerns the parties had. The Commission approves of this compromise, and views it as a standard below which there should be no flexibility. Verizon mistakenly fears the rules as inflexible, where we view the rules as a floor, above which there is great flexibility.

Secondly, both Verizon and Ameren contend that the New Rule would not have prevented the unscrupulous actions of Enron, AES, and Dynegy. (The Companies argue that the situations mentioned only involve long-term credit arrangement, and only one involved the loan of a utility fund.) We disagree. As Staff informs us, Enron attempted to stave bankruptcy by sequestering the loan proceeds of two of its subsidiaries, who engaged in short-term loans, as ordered to by Enron. The Commission regards the Enron case as ample evidence to warrant a standard for MPAs.

Furthermore, Verizon argues that, irrespective of the existence of past unethical financial transactions, the New Rule will not stop such unethical transactions in the future. Again, the Commission disagrees and institutes a new standard for MPAs with just that goal. As recent events have shown us, business are extremely creative with their finances, and no rule or oversight will prevent all such abuses, but an attempt at curbing such behavior will almost assuredly make some difference. And the Commission believes that such an effort is crucial at this time.

B. Existing Money Pool Agreements

1. Staff Initial Comments

Staff initially argued that utilities with existing money pool agreements should be required to file revised agreements that comply with the Proposed Rule within 90 days after the adoption of the final rules.

2. NAWC Initial Comments

NAWC suggests that this requirement be limited to existing money pool agreements that are inconsistent with the requirements of the final rules. There would be no need to re-file an agreement previously approved that is consistent with the final rules.

3. Staff Rebuttal Comments

Staff agrees with NAWC's proposal.

4. Commission Review and Conclusion

The Commission agrees with NAWC and Staff that MPAs that meet the requirements of the New Rule do not need to be re-approved by the Commission. However, money pool agreements inconsistent with the New Rule will need to be revised, and re-filed with the Commission within 90 days after the adoption of the New Rule.

III. SECTION 340.10: APPLICABILITY

A. 340.10(b)

1. Staff Initial Comments

Section 340.10 identifies the entities and types of transactions to which these rules apply. All public utilities as defined in Section 3-105 of the Public Utilities Act ("Act") [220ILCS 5/3-105] and incumbent local exchange carriers as defined in Section 13-202.5 of the Act [220ILCS 5/13-202.5] would be subject to this Part. However, local exchange telecommunications carriers with no more than 35,000 subscriber access lines shall not be subject to this Part pursuant to Section 13-504(d) of the Act [220 ILCS 5/13/504(d)]. This Section also indicates that routine bank transactions, cash management and treasury services, whereby ownership of funds is not transferred or otherwise loaned or advanced to other affiliates, are not subject to the requirements of the Part. These functions are exempt from the rules because the utility retains control over its funds.

2. CTC Initial Comments

CTC notes that Section 340.10(b) appropriately exempts four types of entities and transactions from the scope of the proposed money pool rules. These exemptions include routine bank transactions, cash management and treasury services, long term loans, and loans from an affiliate to an incumbent local exchange carrier. CTC informs us that in the December 13, 2002 draft rules circulated by Staff had included language in three sections of the rule that added a fifth type of exemption from the money pool rule requirements for utilities that did not issue long-term debt. Section 340.10(b)(4) of Staff's December 13,2002 draft comments provided: (4) Loans from utilities that do not issue long-term debt are not subject to the requirements of Sections 340.40 or 340.50. In addition, Sections 340.40(a) and 340.50(a) of the December 13, 2003 draft rules circulated by Staff provided: (a) This Section does not apply to utilities that do not issue long-term debt.

On analyzing the August 12, 2002 Staff Report to the Commission, CTC concluded that Staff based the exemption for utilities that do not issue long term debt on the primary concern that the Commission should prevent situations in which a utility borrowed money from independent third parties like a bank based on the utility's creditworthiness, and then turned around and provided the loaned funds to an affiliate. In this situation, the regulated utility would be directly responsible for the issued debt to the unaffiliated third party (the bank), and be forced to rely upon an affiliated party to repay the loan. CTC contends that in situations where the regulated utility operating in Illinois does not borrow externally or otherwise issue long-term debt, this risk is eliminated. This exemption was significant to CTC because CTC currently does not have any external debt with unaffiliated third parties, and therefore would not be subject to certain requirements contained in the money pool rules including Section 340.40. Accordingly, CTC recommends the following exemption language, similar to the language Staff included in the December 13, 2002 draft rule, be added back into Section 340.10(b) of the Proposed Rules:

> (5) Utilities that do not issue long-term debt to unaffiliated third parties are not subject to the requirements of Section 340.30 or Section 340.40.

CTC further argues that another exemption should be included in Section 340.10(b) to address cash generated by incumbent local exchange carriers from non-regulated and competitive telecommunications services. Section 13-601 of the Act provides that "the provisions of Article VII of this Act are applicable only to telecommunications carriers offering noncompetitive telecommunications service, and the Commission's regulation thereof." 220 ILCS 5/13-601. CTC maintains that as a result, Staff's Proposed Rule will not be imposed on the numerous telecommunications companies that provide only competitive telecommunications service, including: cable television companies (some of which provide high speed data and telephone service), wireless telephone providers (voice and data services), internet service providers, satellite companies (data), long distance companies (data, local and long distance voice), and competitive local exchange providers (all services). Because this regulatory initiative will affect only selected competitors (incumbent local exchange carriers), CTC argues that the Commission must ensure that its rules will not effectively undermine incumbent telecommunications carriers ability to provide competitive services, and compete with telecommunications carriers that are not subject to the money pool agreement rules.

CTC proposes that the money pool agreement rules should not apply to cash generated from competitive or non-regulated services provided by an incumbent local exchange carrier. CTC recommends the following exemption in Section 340.10(b):

> (6) Loans of Surplus Funds generated from an incumbent local exchange carrier's non-regulated or non-competitive services are not subject to the requirements of this Part.

3. Staff Rebuttal Comments

Staff opposes CTC's proposal. Staff agrees that a utility that does not borrow externally is exposed to one less source of risk; nonetheless, the utility's internally generated funds remain at risk. A subsidiary may lend money short-term when it has a long-term but not a short-term need for that money. If a utility did not need those funds for the long-term, then that utility would declare a dividend to make a permanent capital distribution to its parent company. Thus, a utility that makes short-term loans is still putting needed funds at risk; hence, the rule should apply to all such utilities.

Staff opposes CTC's proposed exemption, Section 340.10(b)(6), because competitive telecommunication services remain regulated. Section 13-101 of the Act specifies that Sections of the Act pertaining to public utilities, public utility rates and services, and the regulation thereof, are fully and equally applicable to noncompetitive telecommunications rates and services, and the regulation thereof. 220 ILCS 5/13-101. Staff argues that by accepting CTC's proposed exemption, protecting a utility's non-competitive services would be impossible since both non-competitive and competitive services share much of the same capital investment. Thus, Staff concludes, non-competitive service cash flows would not be sufficient to support a telecommunication carrier's infrastructure alone.

4. CTC Rebuttal Comments

CTC argues that Staff's response to CTC's proposal encourages a utility to make a permanent cash distribution of funds (dividend) to its parent company, with no ability or mechanism for repayment, instead of making a loan for which the Illinois utility will be repaid. CTC contends that a utility may have multiple reasons, including tax implications, and the uncertainty of long-term capital requirements, for not wanting to permanently distribute excess funds. CTC argues that Staff's comments fail to consider these issues.

CTC further argues that Staff's explanation is inconsistent with its general approach of ensuring that the Illinois regulated utility protects its excess cash funds at all costs. It is unclear why an Illinois utility should be forced, as a result of Staff's proposed money pool rules, to give up the right to repayment by declaring a dividend when the Illinois utility may prefer to loan excess funds to an affiliate and retain a right to repayment. The risks associated with the utility issuing long-term debt to unaffiliated third parties is precisely the risk Staff refers to in response to Verizon's comments regarding Enron, AES Corporation, and Dynegy. CTC therefore maintains that if an Illinois utility does not borrow externally and issue debt to unaffiliated third parties, the risks experienced by Enron's and AES Corporation's subsidiaries will not materialize.

5. Staff Surrebuttal Comments

Staff explains that the reference to a utility's option to declare a dividend to make a permanent capital distribution to its parent company rather than lending those funds on a short-term basis was not a recommendation. Staff Rebuttal Comments at 3-4. Rather, Staff explained that when a utility with two options to transfer cash to an affiliate chooses the one in which the utility expects to be repaid, that decision is prima facie evidence that the utility expects to need the money back, which in turn, means that the utility has put needed funds at risk. Staff argues that CTC misconstrued Staff's example as encouraging utilities to make dividend payments to parent companies rather than short-term loans. CTC Rebuttal Comments at 13.

Staff points out that the proposed rule does not encourage utilities to make dividend payments to parent companies when the financial condition of the utility would be impaired by such payments. To the contrary, Section 7-103 of the Act expressly requires that Illinois utilities suspend dividend payments if capital is impaired or would be impaired by such dividend payment. Furthermore, Section 7-103 of the Act authorizes the Commission to order a utility to cease and desist the declaration and payment of any dividend upon its common and preferred stock whenever the Commission finds that the capital of any public utility has become impaired or will be impaired by payment of a dividend. (220 ILCS 5/7-103.)

Staff further disagrees with CTC's claim that a utility "forced" to make dividend payments gives up its "right" to repayment is also specious. CTC Rebuttal Comments at 13. Utilities that are owned and controlled by another entity, with no independent board of directors, have no effective "right" to repayment of a loan to an affiliate. It is highly unlikely that CTC would sue its affiliate for repayment of a loan it extends to an affiliate. A utility such as CTC is repaid if and only if its parent company deems it in its interest to do so. Even if a parent company directed that loan be repaid to a utility, nothing but Section 7-103 of the Act prevents the parent company from also directing the utility to effectively reverse the loan repayment through a dividend payment to the parent company in an amount similar to the loan repayment.

Staff notes that, as CTC observed, an earlier draft of Staff's proposed rule included an exemption for utilities that did not issue long-term debt. That exemption was drafted in recognition that some utilities' access to capital would be very limited on a standalone basis. Such a utility may significantly benefit if an affiliate with greater access to capital raised capital on behalf of the utility.

Staff eliminated the exemption for utilities that do not issue long-term debt because for some utilities, any gains that might be realized from centralizing the capital raising function, may be more than offset by increased risk resulting from a utility's complete dependence on non-utility affiliates for capital. Standard & Poor's ("S&P") has instituted a consolidated ratings methodology that explicitly takes into consideration the degree of insulation between a utility and its affiliates in rating the utility's creditworthiness. When the ratings agencies found that insulation to be lacking, utility credit ratings have been lowered.

Despite the concerns described in the ratings analysis above, UI's Rebuttal Comments indicate that some utilities need to be able to transfer money to an affiliate as part of a larger system through which those utilities obtain funds for investment. Because Staff believes that small utilities should not be exempted from the entire rule, Staff has added additional options for an affiliate to become an Eligible Borrower. Those options are discussed in detail under Section 340.40(b).

6. Commission Review and Conclusion

The Commission rejects CTC's proposal to include an exemption from Sections 340.40 and 340.50, for utilities that do not issue long-term debt. The Commission agrees with staff that utilities without long-term debt from unaffiliated parties are safe from one risk, but only that one risk. Staff's Surrebuttal Comments convince the Commission that utilities need to be insulated from their parent companies and other affiliates to protect their credit ratings, as evidenced by Standard and Poor's and Moody's actions against CILCO. The new money pool rules should increase this insulation in the eyes of the credit raters and investors, in turn enhancing CTC's position. Therefore, the Commission rejects CTC's proposal to exempt from Sections 340.40 and 340.50, utilities that do not issue long-term debt.

B. 340.10(c)

1. Staff Initial Comments

Section 340.10 makes it clear that all agreements that are subject to the requirements of the rules must continue to be filed with and approved by the Commission pursuant to Section 7-101 or 7-102 of the Act. [220 ILCS 5/7-101 and 5/7-102] Finally, Section 340.10 states that the rules do not restrict the authority the Act grants the Commission to impose conditions to its approval of a money pool agreement that the Commission deems proper.

2. Verizon Initial Comments

Verizon contends that the arbitrary nature of the Proposed Rule defeats its purpose. If all of the requirements of the rule can be met, but the rule still provides that a money pooling arrangement could not be implemented by order of the Commission, there is no need for the rule. This condition of the Proposed Rule eliminates any benefit over the current rule. The current statutes governing money-pooling agreements already require that they be filed and approved by the Commission. *See* 220 ILCS 5/7-101 (2) and 5/7-102. Verizon notes that Staff recognizes this fact in Section 340.10 (c), which states: All affiliated interest agreements that are subject to the requirements of this Part must be filed with the Illinois Commerce Commission for approval pursuant to Sections 7-101 or 7-102 of the Act [220 ILCS 5/7-101 and 5/7-102]. This Part shall not limit the Commission from imposing conditions on its approval of a money pool agreement, as it may deem necessary to safeguard the public interest. However, Verizon contends that this means compliance with this rule does not assure that a money pooling agreement is satisfactory. It is possible that such an agreement will still have to meet other unknown tests before it can be approved. This defeats the purpose for a rule, Verizon argues.

Verizon further argues that the rule fails to provide that the Commission should waive certain portions of the rule that when applied to a particular agreement would be contrary to the public interest. Verizon maintains that a utility should be allowed to convince the Commission, for example, that particular provisions of the rule work to the detriment of public interest due to the overall structure of that utility's money pool arrangement. In Verizon's view, while the draft rule provides for additional regulatory burden to utilities, it does not provide for the removal of that burden if that would also be in the public interest.

Therefore, if the Commission determines that Part 340 is necessary, Verizon recommends that Section 340.10 (c) be modified as follows: (c) All affiliated interest agreements that are subject to the requirements of this Part must be filed with the Illinois Commerce Commission (Commission) for approval pursuant to Sections 7- 101 or 7-102 of the Act [220 ILCS 5/7-101 and 5/7-102]. This Part shall not limit the Commission from imposing conditions or waiving certain portions of the rules in its approval of a money pool agreement as it may deem to be in the public interest.

Notwithstanding the above, it is still Verizon's position that the rule is not needed, since the Commission will still need to assess the merits of each money pool agreement on a case-by-case basis. Verizon argues that the rule's attempt to codify specific "one size fits all" requirements regarding money pool agreements will provide added regulatory burden, but because unknown tests can always be added there is no certainty that meeting the rule requirements will assure approval. This problem arises because these types of agreements do not lend themselves to "one size fits all" regulation.

Verizon notes that the Staff has already found it necessary to modify its original draft in order to accommodate the existing money pool arrangement of Ameren. Commission approval of the originally drafted rules would have nullified Ameren's money pool arrangement. However, the same will be true of future agreements, and even some others that are in place today, Verizon contends. There are many unique corporate structures and sizes associated with the various utilities doing business within the State of Illinois. Each utility has unique financing issues and capabilities. A set of codified rules such as the proposed Part 340 cannot possibly capture and anticipate the many alternative arrangements within the public interest that are available. Furthermore, there will certainly be future financial security innovations introduced by the capital markets or more efficient money pool arrangements devised that would be in the public interest. However, the proposed rule cannot anticipate them and will have arbitrarily prohibited them. These types of agreements will always require the same ad hoc review. Thus, the rule adds nothing.

3. Staff Rebuttal Comments

Staff opposes Verizon's proposal to allow the Commission to waive certain portions of the rule when those portions applied to a particular agreement would be contrary to public interest because it would render the rule superfluous. Staff argues that the Proposed Rule provides a set of minimum requirements. In the same way that 83 Illinois Administrative Code Part 285 does not eliminate a utility's obligation to respond to data requests or limit its burden to justify its proposed rate increase to the information specified in that rule, this proposed rule represents a floor which all money pool agreements must at least equal in terms of safety. However, Staff further argues that due to the "creativity" of some companies, which cannot be foreseen, the Commission needs the flexibility to reject portions of a company's money pool agreement.

4. Ameren Rebuttal Comments

Ameren supports a modification to the Proposed Rules to give the Commission the express authority to approve a money pool that is not in full compliance with parts of the Proposed Rule. Ameren understands that the Proposed Rules, if adopted, will provide a baseline of minimum standards. Nevertheless, given different structures of various money pool arrangements and different business circumstances of the participants, the flexibility for the Commission to approve money pools with different features, but features determined to be adequate to meet the goals of the rule, would allow for decision making appropriate for ratepayers and the public interest in specific instances while maintaining this authority at the Commission level. If a "one size fits all" approach to the design of the Proposed Rule is necessary, a mechanism by which adjustments may be made seems only appropriate if the entities bound by the rules operate in different industries and have differing operating characteristics.

5. Verizon Rebuttal Comments

Verizon contends that one reality of the business world is that technological obsolescence, changes in the market place due to political and regulatory processes, or other changes in the financial environment, can put companies or even entire industries into financial distress or bankruptcy. During such times, it is critical that companies have as much flexibility to structure financing arrangements as possible. This may mean that a subsidiary, including utilities, must borrow from a parent company that has poor credit quality, because it may be the only source of funds available to fund the subsidiaries' operations. The Proposed Rule, because of its credit quality requirements, would put any financially distressed Illinois utility in a precarious financial position. This problem would be acute if the Proposed Rule does not provide the Commission the ability to waive provisions of the rule. The Rule should allow the Commission to review such a proposal and not forgo its opportunities. There is no reason to tie the hands of the Commission with this Rule.

6. CTC Rebuttal Comments

CTC contends that Staff's rejection of Verizon's change to the proposed money pool rules ignores the diversity of facts faced by each utility and regulated telecommunications carrier operating in Illinois including: organizational structure and size, capital structure, the capital markets in general, rating agencies, and investors. Given the complex set of facts faced by companies operating in Illinois, the Commission should not attempt to rely upon "one-size-fits-all" rules regarding money pool arrangements for all utilities and incumbent local exchange carriers in the state. CTC supports the change recommended by Verizon.

The money pool rules, CTC argues, should afford companies like CTC the ability to go to the Commission and demonstrate the creditworthiness of an affiliate seeking to participate in a money pool agreement. The proposed money pool rules cannot anticipate and address the numerous alternative capital and financing arrangements that Illinois utilities may consider, and which the Commission could find to be within the public interest if it is given the opportunity.

7. Staff Surrebuttal Comments

Staff agrees that with regard to the situation of Utilities, Inc., that in some cases centralizing the cash management and treasury functions within a single affiliate provides significant economies that should be recognized in the rule. Nevertheless, Staff disagrees with several details in UI's proposal. First, Staff cannot justify treating small water utilities differently than similarly situated small utilities in other businesses. Second, limiting an exemption to utilities that are affiliates to three or more water utilities in the state has no financial and economic basis. Third, UI's proposal would require the Commission to evaluate the terms of a money pool agreement pursuant to Sections 7-101 and 7-102 of the Public Utilities Act, and determine whether a service company's cost, savings and efficiencies allocation are reasonable.

Staff contends that UI's proposal places an undue burden on Staff and the Commission since the statutory requirements of Sections 7-101 and 7-102 of the Act do not address the allocation of savings and efficiencies. Such determinations are typically deferred to rate cases. Sections 7-101 and 7-102 establish public interest and public convenience standards, respectively, and authorize the Commission to condition its approval of an affiliated interest agreement in a manner that achieves those objectives. (220 ILCS 5/7-101(3) and 5/7-102(C).) Section 7-101(2)(ii) addresses costs resulting from affiliated interest transactions to the extent it authorizes the Commission to prescribe guidelines which the electric or gas public utility must follow in allocating costs to transactions with affiliated interests. (220 ILCS 5/7-101(2)(ii).) Section 7-101(3) states that Commission consent of any contract or arrangement under Section 7-101 of the Act does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding. Thus, Staff objects to requiring the Commission to evaluate a service company's cost, savings and efficiencies allocation with respect to Sections 7-101 and 7-102 of the Act for the purpose of exempting utilities from the proposed rule. Finally, for reasons that will be discussed in more detail in the context of Sections 340.30 and 340.40, Staff opposes UI's proposed modification of Section 340.10(b) since it would inappropriately exempt certain utilities from the entire rule.

Staff contends that Verizon's argument mischaracterizes Staff's proposed rule. Under Section 340.30 of the proposed rule, utilities may borrow from affiliates, including parent companies, regardless of the affiliate's credit quality. However, to protect the financial condition of Illinois utilities, affiliates that borrow from Illinois utilities must meet one of the eligibility criteria provided in Section 340.40 of the proposed rule. Furthermore, Section 340.40 prevents a utility from borrowing externally in order to lend to non-utility affiliates. Thus, the proposed rule would not worsen the financial condition of a utility under financial distress. In fact, the proposed rule provides safeguards that would protect a utility from the financial distress of non-utility affiliates since such affiliates would be unable to borrow from a utility without having adequate credit ratings or back up sources of liquidity.

8. Commission Review and Conclusion

First, Verizon argues that the mere fact that the rule leaves money pool agreements subject to Commission review makes the rule arbitrary. The Commission disagrees that this is a negative aspect of the rule. The current rule regarding money pool agreements is even more arbitrary. The nature of this rule will always leave it somewhat arbitrary. But, the new rule actually eliminates much of the arbitrary decision making by the Commission. With a standard for the Commission to base its decisions on, a utility can be fairly sure that if its MPA follows Part 340, it will be very likely that the Commission will approve it. Moreover, a standard will assist a utility in appealing a decision by the Commission. The Commission will base its decisions squarely on Part 340.

Second, the Commission believes that the new rules afford Illinois utilities with all of the benefits of a money pool agreement and do not hinder their financial flexibility in times of stress. As Staff notes, the money pool rules are designed to protect a utility's money, not prevent the utility from borrowing money. The Commission feels that the New Rules do just that. The most hotly contested Section is 340.40: Minimum Requirements for Short-Term loans from Utilities to Affiliates. While no party took issue with Part 340.30: Minimum requirements for Short-Term loans from Affiliates to Utilities. This shows the Commission that neither the utilities nor Staff feel that in times of stress the utilities will be hindered in borrowing money. Therefore, any waiver would be to give utilities more flexibility in lending their monies, exactly what this rule is trying to prevent. So, the Commission sees no need for a waiver of the Part 340 Rules by the Commission. Such a waiver would only encourage MPAs to contest rather than conform to the money pool rules.

IV. SECTION 340.20: DEFINITIONS

A. “High Grade Credit Issuer” and “High Grade Committed Credit Facility

1. CTC Initial Comments

CTC recommends changes to the following two definitions: 1) “High Grade Credit Issuer” and 2) “High Grade Committed Credit Facility.”

CTC notes that in its Proposed Rules definitions, Staff has included the following definition of “High Grade Credit Issuer:” “High-grade credit issuer” means a company that has the following issuer credit ratings from at least two of the following three major credit rating agencies and a higher, equivalent or no credit rating from the third credit rating agency: A- or above by Standard & Poor’s or its successor; A3 or above by Moody’s Investors Service or its successor; or A- or above by Fitch Ratings or its successor.” CTC contends that this definition has significant consequences throughout the Proposed Rule because it provides a credit rating threshold that limits the ability of an “affiliate” company of a regulated ”utility” or incumbent local exchange carrier to borrow funds. In Section 340.40(b)(3), an affiliate of a regulated utility operating in Illinois must be a “High Grade Credit Issuer” to participate in a money pool and borrow from the utility.

CTC argues that a credit rating is the opinion of the rating agency regarding the general creditworthiness of a company. The ratings are a function of risk factors to which a company is subject, and are monitored by the rating agencies and changed based on quantitative and qualitative evaluations of the company, including its competitive situation, industry prospects for growth and the regulatory environment. A rating in and of itself does not provide any information regarding the quality of service the company provides to its customers. According to CTC, it is simply the agency’s evaluation of the company and it ability to repay its debt.

CTC argues that a debt security is “investment grade” if it qualifies for one of the top four ratings from Moody’s, Standard & Poor’s or Fitch’s rating services. An “investment grade” rating means that in the opinion of the rating agencies, the company has a “good” or “adequate” ability to repay its long-term debt. As noted above, the definition of “High Grade Credit Issuer” included in the Proposed Rules requires an A-/A3/A- credit rating level from Standard & Poor’s, Moody’s, and Fitch Ratings, respectively. The credit rating agencies do not issue ratings for companies that do not issue external debt obligations or otherwise participate in the capital markets. CTC has no external debt, and has not been issued a credit rating by any of the three credit rating agencies. In addition, CTC maintains that none of its affiliates meet the stated “High Grade Credit Issuer” criteria having an A-1 or even an A-2 level of short-term commercial paper ratings since no affiliates of CTC currently issue commercial paper. Citizens, the parent company of CTC, is the only affiliate of CTC that has been active in the capital markets. Citizens has current credit ratings of BBB/Baa2/BBB from Standard & Poor's, Moody's, and Fitch Ratings, respectively. Based on the rating agency standards, this means Citizens has a good or adequate ability to repay its long-term debt obligations. However, CTC maintains, if the definition of "High Grade Credit Issuer" is retained in the Proposed Rule, no affiliate of CTC, including Citizens, would satisfy the proposed standard for being able to borrow money from CTC. This could potentially create liquidity issues for CTC, due to the limitations on Citizens to borrow from or transfer funds to CTC.

CTC contends that despite the significance of the definition of "High Grade Credit Issuer" throughout the Proposed Rule, Staff has provided no rationale or explanation regarding how it came up with its proposed definition of "High Grade Credit Issuer" or the use of credit agency rating levels of A- for Standard & Poor's, A3 for Moody's and A- for Fitch Ratings in its definition.

CTC also questions if Staff undertook any review or analysis of the credit ratings that have recently been issued for incumbent local exchange carriers and other utilities operating in Illinois, including Citizens. Consequently, CTC proposes that Staff's use of credit agency rating levels of A- for Standard & Poor's, A3 for Moody's and A- for Fitch Ratings in its definition of "High Grade Credit Issuer" should be changed to allow long term debt ratings that qualify as "Investment Grade" debt securities by two or more of the three major credit agencies.

CTC recommends that the definition of "High Grade Credit Issuer" be changed to "Investment Grade Credit Issuer" with the following credit rating levels:

> Investment-grade credit issuer," means a company that has the following issuer credit ratings from at least two of the following three major credit rating agencies: BBB- or above by Standard & Poor's or its successor; Baa3 or above by Moody's Investors Service or its successor; or BBB- or above by Fitch Ratings or its successor.

In addition, the definition of "High Grade Committed Credit Facility" should be changed to "Committed Credit Facility" as follows:

> "Committed Credit Facility," means credit lines that permit the person to draw funds from financial institutions that are Investment-grade credit issuers.

2. Ameren Initial Comments

Ameren believes the Proposed Rule's standard of credit quality is too stringent for participation in the Utility Money Pool. According to Moody's, over the years 1983-2001, companies rated A3 or above experienced practically no defaults within one year of having this rating. If the minimum credit quality standard were lowered one notch to Baa1, the incremental default rate is only 0.12% (twelve hundredths of one percent).

Companies rated Baa2 had a default rate of only 0.09% (nine hundredths of one percent). Ameren believes that defining "high-grade credit issuer " as a person with a minimum of BBB/Baa2/BBB rating would result in a minimal, and acceptable default risk to the lending utility, yet preserves the benefits of the money pool to a greater universe of affiliated borrowers, in particular the affiliated utility borrowers. Consistent with this acceptable default risk level, Ameren believes a minimum short term rating criteria of A2/P2/F2 should be employed in Section 340.40(b)(1) as the P2 rating is consistent with a rating of at least Baa2 at Moody's.

Ameren's proposal is that any "investment grade" rating be considered the minimum measure of acceptable credit quality. "Investment grade" is a widely used benchmark of credit quality and is considered by Moody's to be Aaa through Baa3 and by Standard and Poor's to be AAA through BBB-. For example, the SEC requires that companies under its jurisdiction maintain at least an "investment grade rating" from one rating agency to engage in financing activities.

Ameren contends that if the Commission imposes such tight credit requirements on borrowing affiliates (or their guarantors), especially on public utility borrowers, it may have an unintended result of unnecessarily and harmfully restricting the liquidity of public utilities. If a strong utility with a BBB rating or a P2 commercial paper rating cannot borrow from its affiliates, it will be required to forego the cost saving advantages of the money pool and seek credit in the bank or public markets. Such credit will almost certainly carry a higher cost – a cost that must be born by utility ratepayers – than what would be available from an efficient money pool arrangement such as the one conducted by Ameren.

Ameren urges the Commission to consider the existing ratings of Illinois' electric and gas utilities. According to publicly available information, it appears that most Illinois electric and gas utilities have either short-term or long-term ratings (but in most cases not both) sufficient to allow them to be borrowers under Section 340.40(b)(1) or (3). However, in most cases the utility that would be the borrower, or the holding company that would guarantee the borrowing, has the lowest rating that would qualify under the Proposed Rule. In these cases, if any company received a ratings downgrade, even by only one rating notch by only one rating agency, it might fall out of compliance which could lead to a liquidity problem for the utility. As has been demonstrated in the energy markets during 2002, the loss of liquidity can have serious consequences and create a crisis even where underlying financial conditions are relatively sound. Ameren believes that moving the requirements for both short-term and long-term ratings to include all investment grade ratings would significantly add to certainty for Illinois utilities and not lead to any material level of incremental risks.

3. NAWC Initial Comments

NAWC proposes that, in the definition of "High-grade committed credit facility," the term "financial institutions" be changed to "companies." With this change, any "high-grade credit issuer" (i.e., any "company" which achieves the required high credit ratings), and not only high-grade credit issuers that are deemed "financial institutions" (a term not defined in the Draft Rule), could provide a "high-grade credit facility." NAWC believes that any "high-grade credit issuer" should be able to provide a "high-grade committed credit facility," and that the reference to "financial institutions" is confusing and unnecessary.

NAWC informs us that the rating agencies (Standard & Poor's, Moody's Investor Service, and Fitch Ratings) use processes designed to produce consistent ratings for companies that issue debt in more than 100 countries. The agencies provide independent financial analyses to investors who look to the agencies' credit ratings for objective information on the ability and willingness of companies to repay their debts on time and in full.

The credit rating process involves consideration of a company's historical performance and a look into the future. The agencies use a multidisciplinary or "universal" approach to risk analysis, which aims to bring an understanding of all relevant risk factors and viewpoints to every rating analysis. The agencies rely on the judgment of a diverse group of credit risk professionals to weigh those factors in light of a variety of plausible scenarios for each company and, thus, reach a conclusion as to what the rating should be.

Several analytical principles guide the reasoning process. First, agencies calculate financial ratios for analysis based on information about individual companies and their industries. However, ratings are not based on a defined set of financial ratios. Rather, they are the product of a comprehensive analysis of each individual company by experienced, well-informed, impartial credit analysts. Factors reviewed include:

- Risk management policies and procedures
- Relative market positions in core business activities
- Consistent business strategy and implementation
- Quality of management

In every sector, the foundation of ratings is the perceived level of risk associated with receiving payment of the principal and interest on debt obligations on time and in full. The analysis focuses, therefore, on an assessment of the level and predictability of a company's future cash generation in relation to its obligations. The main emphasis throughout the rating analysis is on understanding strategic factors likely to support future cash flow, while identifying critical factors that could inhibit future cash flow. The company's capacity to respond favorably to uncertainty is essential. Generally, the greater the predictability of cash flow and the larger the cushion supporting anticipated debt payments, the higher the rating will be.

According to Standard & Poor's Corporate Ratings Criteria, a company that achieves the rating required by the Proposed Rule for a "high-grade credit issuer" would have a "strong" ability to meet its financial obligations. (2002 edition at 7-8). NAWC submits that any company that achieves the required high ratings would, in light of the ratings process, be expected to have a sustainable cash flow sufficient to meet its obligations and, therefore, be qualified to provide a "high-grade committed credit facility." The language of the definitions quoted above that limits the type of "high-grade credit issuer" that can provide a "high-grade committed credit facility" to "financial institutions" should be deleted and replaced with the word "companies."

4. Staff Rebuttal Comments

Staff disagrees to changing the definitions for "High-grade credit issuer" and "High-grade committed credit facility" so the current minimum credit rating requirements (i.e., A-/A3/A-) are lowered to allow investment grade credit ratings (i.e., BBB-/Baa3/BBB-). First, the proposed rule would govern only short-term lending and borrowing; therefore, focus should be on short-term creditworthiness. Long-term credit ratings are useful indicators of short-term creditworthiness only to the extent they correlate with short-term credit ratings. On this score, the lowest of investment grade credit ratings (i.e., BBB/Baa/BBB) fall short. Standard & Poor's indicates that while a company with an "A-" long-term credit rating could also have an "A-1" short-term credit rating, such convergence is rare. An "A-" credit is far more likely to have an "A-2" short-term credit rating. Standard & Poor's Corporate Ratings Criteria 2000 at 79. Thus, permitting companies with "A-" credit ratings to borrow from a utility without a specified minimum level of committed credit facilities represents a compromise to the A-1/P-1/F-1 standard. Staff believes this compromise is acceptable since an obligor rated A-/A3/A- is considered to have a strong ability to meet its financial commitments. In contrast, BBB-rated obligations are more susceptible to adverse economic conditions or changing circumstances.

Staff informs that an investment-grade credit rating could have a short-term credit rating as low as "A-3", as shown on Attachment 2 of Staff Rebuttal Comments. For "A-3" rated companies, backup sources of liquidity should be 100% of the outstanding amount, regardless of the maturity profile. If the proposed rule lowered current minimum credit rating requirements to allow all investment grade credit ratings, including BBB/Baa/BBB, then utility affiliates would be able to borrow from a utility without backup sources of liquidity. Thus, the proposed rule would allow a transaction to occur that would be improbable in the securities market.

Staff disagrees with NAWC's proposal to change the definition of "High-grade committed credit facility," by changing the term "financial institutions" to "companies." The purpose of a committed credit facility, Staff argues, is to provide an alternative source of liquidity.

5. Ameren Rebuttal Comments

Ameren objects to Staff's argument that the borrowing affiliate must be a high grade credit issuer. Lowering the long-term ratings requirement to BBB/Baa2/BBB, as Ameren proposes, would result in a de minimus increase in credit risk based on observed default rates at these rating levels. Further, based on the correlation between an issuer's long-term and short-term credit ratings and the case for negligible additional default risk, this change is supported by default experience at correlative short-term rating levels. Moody's Investors Service indicates that for a 180-day period, default risks are estimated to be 0.00% for P-1 rated issuer and 0.02% for a P-2 rated issuer (i.e. 2 one-hundredths of 1%). It should be noted here that Ameren's money pool borrowings are made on a daily or overnight basis.

Ameren argues that the miniscule default risk at an investment grade ratings level is further mitigated, for purposes of an inter-company money pool arrangement, by the fact that I) at least in the case of Ameren, this arrangement is managed by a centralized Treasury function which is aware of the cash needs and liquidity position of the entities participating in the pool, and 2) with the exception of Ameren's service company, the entities borrowing from the money pool are regulated utilities.

Ameren states that it manages its short- and long-term funding requirements on a centralized basis. Accordingly, at any given time, it is aware of the cash and borrowing positions of its various companies, and is also aware of cash flow cycles, capital expenditure requirements and the timing of long-term debt maturities and new financings. This structure enables the efficient management of funding requirements and protects against liquidity "surprises." An essential feature of this program is a money pool arrangements that allows Ameren to apply surplus funds of one company to the funding needs of others while efficiently using the limited available backup bank liquidity where liquidity is needed most.

Ameren Services Company does not have any external debt obligations and serves at the pleasure of Ameren's regulated utilities. PUHCA restrictions on Ameren Services (e.g., that it bill on the basis of cost eliminates the profit motive and subsidization) affords significant additional protections. Borrowings by Ameren Services from the money pool represent mainly timing differences between the incurrence of administrative costs and the collection of such costs from the affiliated utilities. Thus, the creditworthiness of the services company is *de facto* that of the utilities for which it provides service. The lending by the utility to the services company can also be viewed as merely a payment of services, after their performance but prior to the actual billing.

Ameren further argues that the unnecessarily strict credit requirements may adversely affect the liquidity and financial condition of Illinois utilities. If the Commission imposes such tight credit requirements on borrowing affiliates (or their guarantors), especially on public utility borrowers, it may have an unintended result of unnecessarily and harmfully restricting the liquidity of public utilities. If a strong utility with a BBB/Baa2/BBB rating or a A-2/P-2/F-2 commercial paper rating cannot borrow from its affiliates, it will be required to forego the cost saving advantages of the money pool and seek credit in the bank or public markets. Such credit will almost certainly carry a higher cost -a cost that must be born by utility ratepayers -than what would be available from an efficient money pool arrangement such as the one conducted by Ameren. The additional cost far outweighs the miniscule additional safety afforded to utility lenders by the ratings tests imposed by the Proposed Rule versus an "investment grade" ratings test.

Ameren urges the Commission to consider the existing ratings of Illinois' electric and gas utilities. According to publicly available information, it appears that most Illinois electric and gas utilities have either short-term or long-term ratings (but in most cases not both) sufficient to allow them to be borrowers under Section 340.40(b) (3). However, in most cases the utility that would be the borrower, or the holding company that would guarantee the borrowing, has the lowest rating that would qualify under the Proposed Rule. In these cases, if any company received a ratings downgrade, even by only one rating notch by only one rating agency, it might fallout of compliance, which could lead to a liquidity problem for the utility. As has been demonstrated in the energy markets during 2002, the loss of liquidity can have serious consequences and create a crisis even where underlying financial conditions are relatively sound. Ameren believes that moving the requirements for both short-term and long-term ratings to the level it proposes would significantly add to certainty for Illinois utilities and not lead to any material level of incremental risk.

6. CTC Rebuttal Comments

CTC feels that Staff's proposed rule and supporting comments reveal that Staff's exclusive concern in this proceeding is to ensure that a regulated utility in Illinois does not make a short-term loan of excess funds to an affiliate entity unless the Illinois regulated utility has absolute and unconditional assurance that it will be repaid by the affiliate. CTC further believes that Staff's approach undermines the effective process the Commission has had been in place for reviewing affiliated loan agreements and will preclude certain Illinois regulated utilities from participating in a money pool arrangement. CTC adds that this may have the undesirable effect of limiting the capital available to regulated utilities in Illinois.

CTC notes that Ameren, Verizon, and CTC have argued that the “High Grade” credit rating thresholds proposed by Staff in the money pool rules should be eliminated, or at a minimum reduced from Staff's proposed “High Grade” standard to an “Investment Grade” standard. CTC contends that while Staff's February 18th comments rejected these requests, the record in this proceeding contains no evidence that there is an unreasonable risk of an Illinois utility not being repaid with the change to “Investment Grade” recommended by CTC, Ameren and Verizon. Staff Rebuttal Comments at 5. Instead, Staff continues to take the position that an affiliate seeking to borrow funds from a regulated Illinois utility must meet one of the following three criteria: 1) the affiliate must meet the highest short-term commercial paper rating available (A-1, P-1 and F-1); 2) the affiliate must have High Grade Committed Credit Facilities from financial institutions that are high-grade credit issuers sufficient to provide a back-up source of liquidity for the amounts the affiliate borrows from the Illinois utility; or 3) the affiliate must be a High-grade Credit Issuer with a long term credit rating of A- or above by Standard & Poor's, A3 or above by Moody's Investors Service or its successor; or A- or above by Fitch Ratings before the affiliate can borrow funds. Under Staff's proposal these are the only three acceptable options for establishing the credit-worthiness of an affiliate of an Illinois utility.

CTC reminds us, that neither CTC nor any of its affiliates participate in the commercial paper market, and therefore none of Citizens' companies have a commercial paper credit rating issued by a third party rating agency. As a result, the first of the three criteria proposed by Staff before CTC could loan excess funds to its parent, Citizens is not available simply because none of CTC's affiliates have elected or needed to take on short term commercial paper debt obligations. CTC believes, that under Staff's proposed rules, a company that elects not to incur short term debt through the issuance of commercial paper is more restricted in terms of its ability to borrow money than a company that may have significant short term indebtedness associated with current commercial paper obligations.

CTC argues that under the second acceptable borrowing scenario proposed by Staff in Section 340.30(b)(2), rejecting "Investment Grade" ratings for the affiliate borrowing funds from an Illinois utility, Staff has also effectively rejected a change to reduce the required credit rating of financial institutions that provide the back up credit facility to enable the affiliate to borrow funds.

CTC contends that Staff's definition of "High Grade Committed Credit Facility" requires a minimum-rating requirement on the banks or financial institutions that provide the back up credit facility required in Staff's proposed rules. Staff has provided no explanation why the financial institution providing the back up credit facility must have a "High Grade" credit rating. A committed credit facility is a legal, contractual obligation to provide funds. The obligation to provide funds is not conditioned on the credit rating of the committing financial institution. In the absence of evidence of the inability or unwillingness of a financial institution to meet its obligations, a committed credit facility should not be limited under the Commission's rules to only those commitments from High Grade financial institutions. Even the commercial paper market standards, on which Staff heavily relies, do not require commercial paper to be backed up with committed credit facilities from financial institutions that are "High Grade." Ignoring all other factors, this double protection of a back up source of liquidity and ensuring that the bank or financial institution is a "High Grade" issuer is excessive, inconsistent with industry practice for back up credit facilities and should be eliminated.

CTC believes that Staff's Rebuttal Comments make it clear that because companies that issue commercial paper are encouraged or required to have back up committed credit facilities to support the commercial paper offerings, an affiliate of an Illinois utility that seeks to borrow funds from the Illinois utility must likewise have back up credit facilities as an alternative source of funds to secure any loan from an Illinois utility. However, a loan from one affiliate to another affiliate with the same ultimate corporate parent is strikingly different than a public commercial paper offering. Money pool arrangements have multiple long-term counter-parties who have an established contractual relationship documented in a written money pool agreement. The participants to the money pool arrangement all contribute to the liquidity of the pool on a daily basis and thereby create a shared liquidity resource. It is unlikely each participant will have simultaneous demands for capital. The money pool represents an important and consistent source of funding for all of the parties participating in the pool. In addition, unlike the private commercial paper investor, the Illinois utility has a vested interest in the success of its parent company and affiliates and may ultimately benefit from lower interest rates and costs as a result of its loans to its affiliates.

CTC continues, in contrast to the money pool arrangement, commercial paper transactions involve only two parties. Therefore, an unaffiliated commercial paper investor may seek third party liquidity support (a backup credit facility). Commercial paper investors are indifferent to the underlying company's activities and operations and are only concerned with immediate liquidity, and the return of their money at the end of the term of the commercial paper. The commercial paper investor transaction may be a one-time, short-term investment regardless of any actions or positive or negative events impacting the company issuing the commercial paper. Given the differences between money pool arrangements and commercial paper offerings, Staff's attempt to impose commercial paper issuance standards on money pool agreements in Illinois should be rejected.

CTC also respectfully disagrees with Staff's statement that long-term credit ratings are useful indicators of "short term creditworthiness only to the extent they correlate with short-term credit ratings." A long-term credit rating encompasses an entity's ability to repay all of its debt obligations, both short and long-term. Contrary to Staff's suggestion on page 5 of its Rebuttal Comments that "investment grade credit ratings (i.e., BBB/Baa/BBB) fall short," "Investment-grade" credit ratings provide adequate protection to ensure repayment of loans from an Illinois utility. A debt security is "investment grade" if it qualifies for one of the top four ratings from Moody's, Standard & Poor's or Fitch's rating services. An "investment grade" rating means that in the opinion of the rating agencies, the company has a "good" or "adequate" ability to repay its long-term debt.

In conclusion, CTC contends that although the distinction between "High Grade" and "Investment Grade' long term ratings has been a repeated concern of CTC and other parties in this proceeding, Staff has failed to provide any record evidence of why "High Grade" credit ratings are necessary and why long term Investment Grade ratings are not sufficient. Staff has not identified a single instance in which ratepayers have been protected or would have been protected as a result of a "High Grade" versus "Investment Grade" credit rating. Absent some evidence that ratepayers are at a significantly greater risk if an Illinois utility loans excess funds to an affiliate with Investment Grade credit ratings as opposed to High Grade credit ratings, "Investment Grade" ratings should be the highest credit rating benchmark the Commission includes in the proposed money pool rules.

7. Staff Surrebuttal Comments

a. New Definitions

Staff's revised proposed rule adds definitions for the following: "Small utility" means a utility that has less than $50,000,000 in total capitalization, as reported in the annual report the utility files with the Chief Clerk of the Commission; "Large utility" means a utility that has $50,000,000 or more in total capitalization, as reported in the annual report the utility files with the Chief Clerk of the Commission. The rationale for this distinction is explained in more detail in Section 340.40(b).

Staff's revised proposed rule defines total capitalization as "the sum of short-term debt, long-term debt, preferred stock and common equity for the entire company." This definition is referenced in the definitions of small utility and large utility. The phrase "for the entire company" means that totals are to be used for each component of the capital structure rather than Illinois jurisdictional amounts. "Cash management" means collecting or aggregating customer receipts and paying all vendors and other operating requirements. Cash management is referenced in Section 340.40(b)(7). The definition of "service company" has been expanded to include service companies providing services to utilities pursuant to a service agreement that has been approved by the Commission under Sections 7-101 or 7-102 of the Act. Finally, "medium-grade credit issuer" means a company that has the following issuer credit ratings from at least two of the following three major credit rating agencies and a higher, equivalent or no credit rating from the third credit rating agency: BBB or above by Standard & Poor's or its successor; Baa2 or above by Moody's Investors Service or its successor; or BBB or above by Fitch Ratings or its successor. This term is part of the criteria for becoming an Eligible Borrower pursuant to Section 340.40(b)(7)(B).

b. High-Grade Credit Issuer

CTC, Ameren and Verizon propose that the current minimum credit ratings requirements for high-grade credit issuer and high-grade committed credit facility (i.e., A-/A3/A-) be lowered to allow investment grade credit ratings (i.e., BBB-/Baa3/BBB-). CTC Comments at 2; Ameren Comments at 3; Verizon Comments at 5.

According to CTC, investment grade credit ratings provide strong assurance of the repayment of a loan from an Illinois utility to an affiliate; thus, investment grade ratings should be the lowest qualifying credit rating benchmark the Commission includes in the proposed money pool rules. CTC cites the Fitch Corporate Bond Default Study: A Decade in Review published by Fitch Ratings on November 8, 2001, ("Fitch Study") as support for its proposal. CTC notes that the weighted one-year corporate default rate for a company with a long-term investment grade credit rating was 0.05%. Staff contends that allowing a BBB- long-term credit rating standard in the proposed rule would provide little assurance of repayment for debt obligations since (1) BBB- is the lowest investment grade credit rating available, and is very close to a speculative credit rating; and (2) a BBB- long-term credit rating generally accompanies a Tier 3 CP rating, which, absent 100% liquidity backup, provides insufficient assurance for the safety of utility funds when lent to affiliates on a short-term basis, thereby, undermining the purpose of the proposed rule.

Staff disagrees with CTC's representations that long and short-term credit ratings are interchangeable. Staff argues that short-term debt places far greater demands on the cash flows of a company since the principal must be repaid with far greater frequency. Staff demonstrated that the greater cash flow required for a short-term borrowing program. By comparing the cash flow requirements of maintaining $1000 of capital through two strategies: 180-day CP and two $500 five-year bonds, issued 2.5 years apart. The CP requires the borrower to find a market for $1000 in debt every six months. The 5-year bond strategy requires the borrower to find a market for $500 in debt every 30 months. Clearly, the shorter the term to maturity of the debt issue, the greater the liquidity required to support it.

According to Ameren, lowering the long-term ratings requirements to BBB/Baa2/BBB would result in a negligible increase in credit risk based on observed default rates at these rating levels. Ameren Rebuttal Comments at 3. Ameren cites a Moody's analysis ("Moody's Study") that indicates firms that eventually default have very low ratings long before the default event. Specifically, over 90% of all rated companies that have defaulted since 1983 were rated Ba3 or lower at the beginning of the year in which they defaulted, and almost 80% were rated Ba3 or lower at the beginning of the fifth year before they defaulted. Ameren suggests that it is highly likely that the utility lender and the Commission would have ample warning of the increased risk of default by the affiliate borrower even if BBB-/Baa3/BBB- borrowers were allowed under the proposed rule. Staff argues that like the Fitch Study, the Moody's Study does not provide sufficient evidence that the definition of high-grade credit issuer should be changed to investment grade credit issuer since it sheds no light on the ability of credit issuers to repay short-term obligations absent Tier 1 CP rating or committed credit facilities.

Ameren also proposes allowing affiliates with A-2/P-2/F-2 CP ratings to borrow from utilities. Ameren Rebuttal Comments at 9-10. Ameren argues that the additional default risk for a P-2 rated CP issuer is negligible in comparison to that of a P-1 rated CP issuer. Ameren Rebuttal Comments at 3. While factually correct, Staff believes Ameren's argument is misleading. "Moody's defines a commercial paper default as any delayed, foregone, or incomplete disbursement of principal or interest." Moody's Investors Service, "Commercial Paper Defaults and Rating Transitions, 1972-2000," October 2000 at 12. Moody's definition of default does not include instances in which the CP issuer had to draw on backup sources of liquidity, such as a committed credit facility, to refund CP. Consequently, default rates are not a useful means for determining the minimum credit rating that should be used in this rule. To determine whether a particular credit rating represents sufficient assurance that an affiliate can repay its short-term loan to a utility, one would need to know the rate that borrowers with that credit rating were forced to resort to committed credit facilities and other backup sources of liquidity to avoid default. However, the Moody's Study does not provide such statistics.

The low default rate on P-2 rated CP does indicate that credit rating or the corresponding long-term credit rating Baa are sufficient for borrowing on a short-term basis from utilities. The Moody's Study clearly indicates that P-2 rated CP issuers must have committed credit facilities to reduce the risk that a sudden withdrawal of credit will precipitate a liquidity crisis that leads to default.

CTC recommends removing the "high-grade" requirement from the "high-grade committed credit facility" definition. According to CTC, a committed credit facility is a contractual obligation to provide funds and is not conditioned on the credit rating of the committing financial institution. CTC Rebuttal Comments at 4. CTC argues that the double protection involving both a back up source of liquidity and ensuring that the financial institution is a high-grade issuer is excessive, inconsistent with industry practice for back up credit facilities and should be eliminated. CTC argues that money pool participants create a shared liquidity resources and it is unlikely that each participant will have simultaneous demands for capital. *Id.* at 5. Staff argues that Fitch Ratings' guidelines for CP ratings contradict CTC's position. With regard to the creditworthiness of banks providing liquidity backup for CP programs, Fitch Ratings states, "In general, the weighted long-term Ratings of the banks providing credit should be A or better; commitments provided by banks BBB+ or lower are not included in the calculation of CP backup." Fitch Ratings, "Corporate Commercial Paper Liquidity Guidelines," April 24, 2001. For the same reasons given with respect to high-grade issuers, a high-grade committed credit facility enhances the safety of utility funds. Thus, the requirement for a high-grade committed credit facility should remain in the proposed rule.

Verizon states that on February 24, 2002, the Securities and Exchange Commission ("SEC") designated Dominion Bond Rating Service Limited ("Dominion") a Nationally Recognized Statistical Rating Organization ("NRSRO"). According to Verizon, if the proposed rule is not modified to recognize Dominion as a valid credit rating agency, then Illinois utilities will not be able to take advantage of lower credit rating fees that could result from competition in the credit rating industry. Verizon Rebuttal Comments at 3. Staff opposes Verizon's proposal. First, Dominion's description of its rating review process is insufficient for determining whether Dominion's long-term and CP credit ratings are scaled similarly to those published by S&P, Moody's and Fitch Ratings. Dominion's long-term investment grade credit ratings are designated AAA (highest), AA (superior), A (satisfactory) and BBB (adequate) whereas Dominion's CP credit ratings are designated R-1 (i.e., prime credit quality), R-2 (i.e., adequate credit quality) and R-3 (i.e., speculative credit quality). Dominion also uses "high", "middle" or "low" as subset grades to designate the relative standing of the credit within a particular rating category. Although Dominion's long-term investment grade credit rating scale appears similar to the long-term investment grade credit rating scale used by S&P, Moody's and Fitch Ratings, the same is not true with respect to CP credit ratings. S&P, Moody's, and Fitch Ratings describe Tier 1 CP obligors as strong, Tier 2 CP obligors as satisfactory, and Tier 3 CP obligors as adequate. Dominion's R-2 CP rating appears to correspond closely with S&P, Moody's and Fitch Ratings' Tier 3 obligors; and, it follows that Dominion's R-1 (low) or R-1 (middle) CP rating would correspond to S&P, Moody's and Fitch Ratings' Tier 2 CP ratings, which unlike Tier 1 CP ratings, require additional backup liquidity sources. Due to the differences between the CP rating scales used by S&P, Moody's and Fitch Ratings, and the CP rating scales used by Dominion, Staff opposes including Dominion credit ratings in the proposed rule at this time. Second, Staff has not found any published documents revealing the relationship between Dominion's long-term and CP credit ratings. Third, currently no Illinois utilities have been assigned a long-term or short-term rating by Dominion. If Illinois utilities are assigned credit ratings by Dominion, then a technical change could be made to the rule to include Dominion as a credit ratings agency. A technical change of this nature should require relatively little time, which would not harm Illinois utilities.

Verizon proposes that references to specific credit ratings agencies through the proposed rule be moved to Section 340.20. Furthermore, Verizon proposes defining eligible credit ratings agencies as those designated an NRSRO by the SEC. Verizon suggests that this proposal would enable the proposed rule to withstand restructurings within the credit rating industry. Verizon Rebuttal Comments at 5. Although Staff does not disagree with the intent of Verizon's proposal, the SEC does not publish or otherwise provide a list of credit ratings agencies with the NRSRO designation. Thus, Staff would be unable to determine whether a given credit ratings agency has received the NRSRO designation; and, given the credit ratings agency received the NRSRO designation, whether it remains in compliance with the SEC requirements for the NRSRO designation. Thus, Staff objects to Verizon's proposal since it would be difficult to implement. Furthermore, investigation would be necessary to determine how a new NRSRO's credit rating scale compares to existing NRSRO credit rating scales.

8. Commission Review and Conclusion

The Commission accepts Staff's new definitions, and maintains the definitions of "High Grade credit issuer" and "High Grade committed credit facility" as one of the minimum requirements for affiliates borrowing from utilities. The Commission objects to lowering the credit rating to Investment Grade, as Staff notes, investment grade long-term rating can mean an A-3 short term rating by Standard and Poor's. CTC contends that under the new rules none of its affiliates or parent company could participate in money pools with CTC. CTC argues that this could cause, "liquidity issues for CTC[the utility], due to the limitations on Citizens[its Parent] to borrow from or transfer funds to CTC." CTC Initial Comments at 12. Yet, CTC does not explain why or how these "liquidity issues" would arise. Nor do they explain how CTC would benefit if its un-rated affiliates and its parent company with only adequate credit borrow from it. No contesting party has explained to this Commission why an affiliate of an Illinois utility, unrelated to the functions of the utility should be allowed easy access to the utility's money.

Furthermore, Ameren comments that if the rules are adopted utilities will not be able to save costs by borrowing from their affiliates. No place in the rule is source of a utilities loan limited to a the contested definitions of "High-Grade credit issuer" or "High Grade committed credit facility." As Staff later notes, no party took issue with Section 340.30: Minimum Requirements for Short-Term Loans from Affiliates to Utilities. Yet, Ameren, CTC, and Verizon all misconstrue Section 340.40: Minimum Requirements for Short-Term Loans from Utilities to Affiliates, to hinder the liquidity of an Illinois utility. Since no party has taken issue with Section 340.30, the Commission will maintain the standards set forth in the attached Appendix for utilities loaning money to affiliates.

V. SECTION 340.30: MINIMUM REQUIREMENTS FOR SHORT-TERM LOANS FROM AFFILIATES TO UTILITIES

A. Staff Surrebuttal Comments

No party to this proceeding has objected to any provision contained in Section 340.30 of the proposed rule. Nonetheless, UI proposes a rule to exempt certain small water utilities from Sections 340.30 and 340.40, and CTC proposes that the proposed rule exempt utilities that do not issue long-term debt to unaffiliated third parties from Sections 340.30 and 340.40. UI Rebuttal Comments at 4; CTC Rebuttal Comments at 13. Staff opposes exempting any utility from Section 340.30 since it provides minimum guidelines for short-term loans extended to a utility from its affiliates. Specifically, Section 340.30 requires that the terms of a short-term loan to a utility from an affiliate are provided in the form of a promissory note or in the money pool agreement itself; prohibits a utility from borrowing from its affiliates if it can borrow at a lower cost from another lender; and prohibits affiliates from charging a utility an interest rate on a short-term loan that exceeds the affiliate's actual interest cost. Neither UI nor CTC provide any rationale for exempting a utility from those minimum requirements.

B. Commission Review and Conclusion

The Commission regards Section 340.30 as the standard by which utilities must adhere to in order to borrow from an affiliate. Since no party directly addressed these standards, the Commission shall adopt them as proposed by Staff, without further comment.

VI. SECTION 340.40: MINIMUM REQUIREMENTS FOR SHORT-TERM LOANS FROM UTILITIES TO AFFILIATES

A. Section 340.40(a)

1. Staff Initial Comments

Staff proposes that Section 340.40 specify the minimum requirements for short-term loans from utilities to affiliates. This section states that a utility may only borrow from outside the money pool agreement in order to make loans to affiliates that are utilities. Under an agreement approved in Docket No. 98-0664, AmerenUE issues commercial paper to raise short-term funds for both itself and AmerenCIPS. This language was added to permit AmerenUE to continue operating its commercial paper program in this manner.

A utility may not borrow from outside the money pool agreement in order to make loans to non-utility affiliates, except for loans to service companies, and subsidiaries of the utility, because the utility should not be allowed to incur obligations that are for the benefit of its non-utility affiliates rather than for the benefit of the utility. That is, a utility should participate in a money pool only if that participation benefits the utility. Money pool agreements should not be a vehicle for subsidies or for the assumption of risks that are unnecessary for the utility to carry out its obligations under the Act. Since a service company exists to perform services for the utilities and its costs will be substantially passed through to the utilities, utilities should be permitted to raise funds on the behalf of the service companies.

Similarly, according to Staff, the rules would permit a utility to borrow externally to lend money to a subsidiary since some subsidiaries exist primarily to provide services to utilities. For example, MidAmerican Energy Company ("MEC") currently has a Commission-approved loan agreement (Docket No. 98-0393) under which MEC advances funds to a subsidiary, CBEC Railway Inc., which maintains a railroad line that connects an MEC power plant to a railroad. Therefore, a utility may borrow externally to make loans to subsidiaries of the utility to permit arrangements such as MEC's.

Staff notes that to be eligible to borrow from the utility, an affiliate must meet one of five requirements to ensure that the utility can call in its funds when the utility needs those funds. First, the affiliate would qualify if it maintains the following commercial paper ratings from at least two of the following three credit rating agencies and a higher, equivalent, or no credit rating from the third credit rating agency: A-1 or above from Standard & Poor's; P-1 from Moody's Investors Service; and F-1 or above from Fitch Ratings. Second, the affiliate would be eligible if the aggregate amount of funds the affiliate borrows from the utility does not exceed the unused balance of funds available to the affiliate under high-grade committed credit facilities at any time. For the purposes of these rules, "high-grade committed credit facilities" are defined as credit lines that permit the affiliate to borrow funds from financial institutions that maintain ratings of A- or above from S&P or the equivalent from at least two of three major credit rating agencies. Third, the affiliate would qualify if it maintains ratings of A- or above from S&P or the equivalent from at least two of three major credit rating agencies. Fourth, the affiliate may borrow from the utility if the aggregate amount of funds the affiliate borrows is guaranteed by an affiliate that maintains a commercial paper rating of A-1 or above from S&P or the equivalent from at least two of the three major credit rating agencies. The final eligibility option allows the affiliate to borrow from the utility if the aggregate amount of funds the affiliate borrows is guaranteed by an affiliate with a high-grade committed credit facility.

The credit rating and committed credit facility requirements above are designed to provide a high level of assurance that utilities will be able to recover money lent to affiliates on demand. The time periods during which companies with A-1/P-1/F-1 short-term credit ratings (“High-Grade”) are unable to access the commercial paper market are rare and usually short-lived. Further, to maintain High-Grade short-term credit ratings, the credit rating agencies require commercial paper issuers to partially support those issuers’ commercial paper programs with committed credit facilities. Thus, High-Grade short-term credit ratings indicate that funds lent to High-Grade commercial paper issuers are very safe. In contrast, the credit ratings agencies require A-2/P-2/F-2 rated (“Medium-Grade”) commercial paper issuers to maintain higher levels of committed credit facilities support for commercial paper programs than High-Grade commercial paper issuers; Medium-Grade commercial paper issuers’ access to the commercial paper market is interrupted more frequently and typically for longer time periods. Nevertheless, the credit ratings agencies differ on the minimum level of committed credit facilities support a Medium-Grade commercial paper issuer should maintain. To provide the highest degree of safety for funds lent to Medium-Grade commercial paper issuers, the Commission should adopt Fitch Ratings’ 100% committed credit facilities support requirement as the most conservative among the three credit ratings agencies. Thus, the proposed rules require 100% backup for utility money lent to affiliates that do not have High-Grade commercial paper ratings. Under the rules, that backup would comprise a combination of committed credit facilities and U.S. Government securities described in Section 340.50(a)(3) of the rules. Only committed credit facilities provided by financial institutions that meet the A- credit rating requirements would be counted as backup for the funds borrowed from the Companies. This minimum credit rating would provide assurance that the financial institutions have sufficient liquidity to honor their commitments. Together, the requirements described above would provide a high degree of assurance that a borrower would be able to repay the funds borrowed from the utility when needed.

Section 340.40 further specifies that the affiliate shall repay the principal amount of the loan plus interest on demand. The utility would not be permitted to loan funds to an affiliate if the utility can earn a higher rate of return on investments of similar risk in the open market. This requirement ensures that the utility’s funds will be invested in a manner that provides the highest return available. This Section states that interest shall accrue monthly on loans from utilities to affiliates to ensure that the utility is earning a return on its funds. This Section also defines what shall constitute an event of default.

2. Nicor Initial Comments

Nicor contends that as long as the parent of a utility complies with the same credit rating requirement—ensuring that the utility has the ability to “call in its funds when the utility needs those funds” –there is no apparent reason for prohibiting a utility from making short-term loans to its parent. Staff Initial Comments at 4.

For this reason, Nicor proposes that Section 340.40(a) should be changed to allow a utility to make short-term loans to its parent, when that parent owns 100% of the outstanding capital stock of the utility, and maintains the following commercial paper ratings from at least two of the three major credit rating agencies and a higher, equivalent, or no paper rating from the third credit rating agency: A-1 or above from

Standard & Poor's or its successor; P-1 or above from Moody's Investors Services or its successor; and F-1 or above from Fitch Ratings or its successor.

In addition, Nicor, Inc., Nicor Gas' parent, must comply with the terms of the recently approved Short Term Borrowing and Investment Between Parties Addendum to the Operating Agreement between Nicor Inc. and Nicor Gas dated October 25, 2001 Nicor Initial Comments Exhibit A. Those requirements, along with a requirement that Nicor, Inc. maintain a prime-1 short-term credit rating, are objectively sufficient to satisfy the three underlying objectives to the proposed money pool rule enunciated by Staff. *See* Staff Initial Comments at 2.

3. CTC Initial Comments

CTC states that the first sentence in this provision would allow a utility to borrow funds and to provide those funds to a utility that is a public utility under applicable state law. For example, if all of the other rigorous standards included in the Staff's proposed rules could be satisfied, CTC could potentially borrow funds and loan the funds to its affiliate providing regulated telecommunication service in Nebraska.

CTC further states that under the second sentence of Section 340.40(a) proposed by Staff a utility may borrow outside the money pool and make loans to "service companies" and subsidiaries of the utility. The utility, however, cannot loan money to its Parent Company under this provision.

CTC contends that Staff has provided no rationale or explanation as to why a utility should be able to loan money to a service company and its subsidiaries, but not a parent company that is the primary affiliated entity engaged in raising capital and performs services for a utility. Citizens is the only affiliate of CTC that has been active in the capital markets. Without the ability of the parent, Citizens, to borrow surplus funds from CTC, Citizens' credit rating may be impacted negatively, and Citizens' ability to provide future capital funding to CTC may be limited.

Therefore, CTC proposes that Section 340.40(a) be modified as follows to allow a utility to make loans to a Parent Company affiliate:

> a) A utility may borrow from outside the money pool agreement in order to make loans to an affiliate that is a public utility under applicable state law. A utility may not borrow from outside the money pool agreement in order to make loans to nonutility affiliates, except for loans to service companies, a Parent Company that is the primary affiliate entity engaged in the capital markets and subsidiaries of the utility.

4. Staff Rebuttal Comments

Staff argues that neither Nicor nor CTC explain what utility or public interest is furthered by this proposal to allow a utility to borrow outside the money pool agreement to make short-term loans to its parent company. Utilities are not banks. Utilities are not granted certificates to be in the business of borrowing on behalf of parent companies or other non-utility affiliates. CTC's proposal is particularly baffling since it would permit an entity that by definition has little if any access to the capital markets to borrow from those markets, and lend the proceeds to an affiliate that by definition has such access. Exempting parent companies from the criteria outlined in Sections 340.40(a) and (b) would undermine the objectives of the proposed rule by eliminating the safeguards intended to protect the utility's financial condition.

5. Nicor Rebuttal Comments

Nicor Gas proposes that Section 340.40, Minimum Requirements for Short-Term Loans from Utilities to Affiliates, be modified as follows:

> (a) A utility may borrow from outside the money pool agreement in order to make loans to an affiliate that is a public utility under applicable state law. A utility may not borrow from outside the money pool agreement in order to make loans to non- utility affiliates, except for loans to service companies and, subsidiaries of the utility. and a Parent Company that owns 100% of the outstanding capital stock of the utility and maintains the following commercial paper ratings from at least two of the following three major credit rating agencies and a higher, equivalent, or no credit rating from the third credit rating agency: A-1 or above from Standard & Poor's or its successor; P-1 or above from Moody's Investors Service or its successor; and F-1 or above from Fitch Ratings or its successor. A loan from a utility to a Parent Company as described above shall bear interest at the utility's borrowing cost plus 25 basis points.

Staff asserts that "[e]xempting parent companies from the criteria outlined in Sections 340.40(a) and (b) would undermine the objectives of the proposed rule by eliminating the safeguards intended to protect the utility's financial condition." The Company's proposed modification to Section 340.40(a), however, objectively provides such safeguards. For example, the Company's proposal would permit a utility to borrow outside of the money pool to make a short-term loan to the parent company only if the parent company maintains the following commercial paper ratings from at least two of the following three major credit rating agencies and a higher, equivalent, or no credit rating from the third credit rating agency: A-1 or above from Standard & Poor's or its successor; P-1 or above from Moody's Investors Service or its successor; and F-1 or above from Fitch Ratings or its successor.

Notably, the Company's proposal in this respect is identical to the eligibility requirement for affiliates borrowing from the utility set forth in Section 340.40(b)(1) of the proposed money pool rule. In addition, of the five affiliate eligibility requirements set forth in Section 340.40(b)(1)-(5), Nicor Inc., Nicor Gas' parent, objectively qualifies under the criteria in (b)(1) and (b)(2), and would qualify for criterion (b)(3) under a standard rating methodology if it had outstanding long-term debt to rate. Of course, the criteria in Sections (b)(4) and (b)(5) would not apply to a parent company such as Nicor Inc.

Moreover, as explained in its Initial Comments (at 2), the Nicor's proposal requiring the parent company to maintain a high- grade credit rating – which is identical to the affiliate requirement in Section 340.40(b)(1) – would help to ensure that utilities are able to recover funds on demand. In fact, not only does Nicor Inc. possess high-grade commercial paper ratings consistent with the affiliate requirement in Section 340.40(b)(1), it also maintains 100% back- up lines of credit from high- grade credit issuers. Consequently, there is a high level of assurance that Nicor Gas would be able to recover money lent to Nicor Inc. on demand.

Furthermore, Section 340.40(d) of the proposed money pool rule provides that a "utility shall not lend funds to an affiliate if the utility can earn a higher rate of return on investments of similar risk in the open market." If the Company's proposal is adopted, the parent company would be required to pay the utility 25 basis points more than its borrowing cost, and thus, the utility would earn an above- market interest rate on a risk-adjusted basis.

Nicor Gas disagrees with Staff's contention that permitting parent companies to borrow from utilities would, as a matter of course, undermine the objectives of the proposed money pool rule is belied by the fact that the Company has engaged in this practice since 1976, when Nicor Inc. was formed, without incident. Indeed, the most recent operating agreement between Nicor Gas and Nicor Inc., approved by the Commission in Docket No. 00-0537, authorizes Nicor Gas and Nicor Inc. to loan short-term funds to each other, subject to the requirements set forth in the Short Term Borrowing and Investment Between Parties Addendum to the Operating Agreement, which was approved by the Commission on October 25, 2001. Nicor Gas notes that the requirements of the Operating Agreement, along with the requirement that Nicor Inc. maintain a high- grade credit rating, plainly satisfy the objectives of the proposed money pool rule.

Nicor Gas proposed that Section 340.40(a) allow a utility to borrow outside the money pool agreement to make short-term loans to its parent company, when that parent owns 100% of the outstanding capital stock of the utility and maintains at least two of the following CP ratings: A-1/P-1/F-1 and a higher, equivalent or no credit rating from the third credit rating agency. Nicor Gas' proposal includes an interest rate premium of 25 basis points for loans that a utility extends to its parent company.

6. CTC Rebuttal Comments

CTC generally does not participate in the capital markets. The only affiliate of CTC that regularly participates in the capital markets is its parent company, Citizens.. Staff's proposed rules preclude an Illinois utility from borrowing outside the money pool and making a loan to its parent company. However, under Staff's proposal the Illinois utility can borrow outside the money pool and loan the money to non-utility subsidiaries and service companies. See Staff Attachment 1 – Section 340.40(a). Staff's Rebuttal Comments refer to CTC's request that the ability to make loans to non-utility subsidiaries and service companies be expanded to include a parent company as "baffling." Staff has provided no rationale or explanation as to why a utility should be able to loan money to a service company and its subsidiaries but not a parent company that is the primary affiliated entity engaged in raising capital and performs services for a utility. This distinction between "affiliates" and a "parent" is truly "baffling."

7. Staff Surrebuttal Comments

Staff proposes exempting service companies and utility subsidiaries from the general prohibition against a utility lending externally to non-utility affiliates since service companies and utility subsidiaries are often established to provide services that directly benefit the utility. Staff opposes any money pool agreement proposal that would permit utilities to lend externally borrowed funds to any non-utility affiliate whose business or purpose is not directly related to the provision of services to utilities.

Staff opposes Nicor Gas' proposal. Given that Standard & Poor's published long-term and CP credit ratings are AA/A-1+, respectively, for both Nicor Gas and its parent company, the benefits resulting from Nicor Gas borrowing funds externally to lend to its parent company are doubtful at best. Both companies presumably have equal access to the capital markets given their equal credit ratings. Thus, the only logical reason that a parent company would prefer to borrow from its utility subsidiary would be to lower borrowing costs to both the utility and parent company. If so, then the parent company should raise the short-term capital and lend it to the utility, thereby reducing the utility's exposure to liquidity risk.

CTC also proposes permitting utilities to borrow externally to lend to its parent company. Neither Nicor Gas nor CTC explain what utility or public interest is furthered by this proposal. As stated in Staff Rebuttal Comments, utilities should not assume unnecessary risks by incurring debt obligations for the benefit of non-utility affiliates. Moreover, money pool agreements are not vehicles for subsidies between utility and non-utility affiliates. Thus, permitting parent companies to borrow funds a utility raised outside the money pool agreement would undermine the objectives of the proposed rule by eliminating the safeguards intended to protect the utility's financial condition.

8. Commission Review and Conclusion

The Commission adopts Staff's proposal exempting service companies and utility subsidiaries from the general prohibition against a utility lending externally to non-utility affiliates since service companies and utility subsidiaries are often established to provide services that directly benefit the utility.

Furthermore, the Commission agrees with Staff that there is no benefit to a utility to borrow externally for the sake of its parent company. While a service company or other affiliate may benefit from a utilities ability to borrow externally, the parent company is not in the same situation as the service company. The parent company can generally borrow externally, and has no need to place the utility at risk by borrowing funds that the utility had to borrow externally. Neither Nicor nor CTC persuade the Commission. Neither states any positive reasons for allowing such a transaction.

B. Section 340.40(b)

1. Staff Initial Comments

(*Supra* E(1)(a))

2. Ameren Initial Comments

Ameren notes that Section 340.40(b)(2) of the Proposed Rule would require a borrower – including an affiliated public utility company or a PUHCA approved service company – who did not have A1/P1/F1 short-term credit ratings or an "A" level long-term rating to also maintain either unused lines of credit or liquid investments equal to the amount of money borrowed (or obtain a guarantee from a highly rated affiliate), Ameren contends. Ameren contends that this requirement eliminates most if not all of the advantage of a money pool arrangement that will result in increased borrowing costs for Illinois public utilities and will provide little additional protection to the lending public utilities.

Ameren states that under current conditions, if AmerenUE or AmerenCIPS sought to borrow from the other, they may be required to comply with the Proposed Rule by (A) obtaining additional lines of credit for the borrower thus duplicating necessary credit or (B) obtaining a guaranty from Ameren.

Ameren argues that duplicate lines of credit increase the borrowing costs. Ameren informs us that lines of credit require payment of commitment fees to the bank, and Ameren reports it is finding that committed lines of credit are increasingly difficult to obtain from banks even for financially strong entities such as Ameren's utilities. These banks have limits on the amount of credit they can make available to each utility system, a situation that has become exacerbated due to bank consolidations over the past few years. Consequently, if a company such as Ameren has reached the limit imposed by these major banks, even if its finances would support additional borrowing, it will be extremely difficult to find additional commitments for credit. The "double counting" imposed by the Proposed Rule, therefore, will work a real hardship on Illinois utilities.

Ameren argues that the effect of these provisions is to potentially double the amount of external credit commitment that is required. For example, if AmerenUE accesses the commercial paper market, it must have committed credit lines in an amount equal to the outstanding commercial paper. If it lends the amount obtained from commercial paper to AmerenCIPS and if AmerenCIPS must also have, under the Proposed Rule, uncommitted credit lines equal to the borrowing, then the amount of committed credit lines the overall Ameren system must have is doubled, but its real borrowing capacity remains the same. The effect is to pay twice as much for credit support as otherwise would be the case.

Ameren believes that while there might be some small savings in interest rate if the affiliate borrows through the money pool from its utility affiliate, this savings, if any, would be offset or eliminated by the commitment fees necessary to comply with the Proposed Rule, Ameren argues. Further, if the borrowing affiliate has liquid investments, it would probably be better off using these funds for its cash needs rather than borrowing through the money pool.

This Proposed Rule may be appropriate if the borrowing affiliate is a non-utility company; however, when the borrowing affiliate is another utility that does not maintain its own independent cash management function (i.e., it does not issue commercial paper and does not incur the expense of maintaining back-up lines of credit or liquid investments), then the Proposed Rule would force that utility to incur more expense to establish and maintain its own arrangements.

The principal advantage to the money pool in the Ameren system is the ability to maximize the effectiveness of borrowing capacity and scarce committed credit lines among Ameren's public utilities. This advantage would be lessened or eliminated by the Proposed Rule.

Secondly, Ameren states that it would not be permitted to guaranty the obligations of one of its utility subsidiaries to another without receiving approval from the SEC under PUHCA. Although AmerenUE and AmerenCIPS are sound utilities, they do not possess the short-term ratings necessary to satisfy the Proposed Rule. Ameren welcomes the provision of the Proposed Rule that would allow the borrowing entity to satisfy Proposed Rule 340.40(b) through specified long-term ratings (i.e., if the borrower is a “high-grade credit issuer”). This will allow Ameren to provide guaranties required by the Proposed Rule because it does not have the highest short-term rating and would not qualify under Section 340.40(b)(4). As noted below, however, Ameren questions whether the long-term rating requirement set out in the Proposed Rule is more stringent than is required, especially when the borrower is also a regulated public utility.

Thirdly, Ameren notes that the Proposed Rule does allow a utility to borrow external funds for lending to an affiliated utility or a service company. Section 340.40(a). As recognized by the Staff in its comments of January 21, 2003, this is an important provision for Ameren. However, Section 340.40(b) still requires that the borrower (be it another public utility or a service company) must (1) maintain the highest commercial paper ratings (A1/ P1/ F1), (2) have all of its short-term indebtedness, including that borrowed from the utility, “covered” or secured by committed credit facilities or permitted short-term investments, (3) itself be a high grade credit issuer or (4) have its obligations guaranteed by an affiliate that has the highest grade commercial paper ratings or “A” level long-term ratings.

Ameren Services, the SEC mandated service company of the Ameren system, is authorized by the SEC to borrow funds from the Utility Money Pool. Ameren Services conducts much of the administrative work of AmerenUE and AmerenCIPS (such as legal, accounting, human resources and so on) that the utilities would have to provide themselves otherwise.

Ameren Services argues that it incurs working capital requirements in order to provide these services and it is appropriate that Ameren Services be able to borrow from the utilities for whose benefit this working capital requirement is established. Ameren Services does not have any securities ratings because it does not access the capital markets directly. There is no reason for it to have securities ratings, and it would be expensive and inefficient for it to obtain ratings solely to be able to comply with the Proposed Rule. Ameren Services exists solely to serve the needs of the Ameren subsidiaries and to best comply with the restrictions of PUHCA. The SEC under PUHCA heavily regulates it. It is, in effect, merely an alter ego of the utility subsidiaries. Ameren believes that in these circumstances there is little risk that the utilities' available funds will be misspent by Ameren Services or unavailable to meet the needs of the utilities when required.

Ameren has balanced its cash needs and cash requirements to allow for efficient and cost effective borrowings for the utility system as a whole. Consequently, there has been no need to have Ameren Services borrow from outside sources. This does not result in any harm or risk to the utility companies -- they are the ones that benefit from Ameren Services. The cost of the essential services provided to the utilities by Ameren Services would increase if Ameren Services had to go to external sources to fund its working capital requirements.

Ameren recommends that the Proposed Rule be modified to allow SEC approved service companies to borrow from the utilities in the holding company system without the need to obtain securities ratings or provide liquidity or a guarantee. This can be accomplished by a very simple addition of a new clause (6) to Section 340.40(b) reading: "6) The affiliate is a service company."

3. Verizon Initial Comments

Sections 340.40 (b) and 340.50 (a) of the draft rule set credit rating requirements for 1) utilities that desire to invest excess funds in an affiliate money pool and 2) the investment of money pool funds outside of the money pool. Verizon argues that these requirements would have the following unintended and adverse consequences.

First, a proposed rule that would include the maintenance of certain commercial paper ratings from at least two credit agencies for the financing affiliate would preclude smaller utilities, which may not have access to the commercial paper market, from participation in a money pool.

Moreover, the limitation to commercial paper markets is too restrictive. There are other ways to fund a cost effective money pool besides borrowing from the commercial paper market with the attendant maintenance of credit ratings. A bank loan is just one example.

Verizon further argues that requiring a money pool or investments by a money pool must maintain commercial paper ratings is unreasonable. Such a requirement goes beyond what is required by capital markets for investments of money market funds. It also exceeds what is required under federal securities law for investments in money market funds. *See* 15 U.S.C. § 80a-1*, et seq*. (Investment Company Act of 1940, hereafter the "Investment Act"). The proposed rule would unreasonably prohibit other safe and legitimate investment options for the money pool.

Verizon further argues that these rule sections are also unrealistic, because there will undoubtedly be unanticipated changes in credit agency criteria for maintaining credit ratings. There will be restructuring of the credit agency industry (*i.e.*, mergers of existing nationally recognized credit agencies as was the case for Fitch Ratings and Duff & Phelps during 2000, the acceptance of new or existing credit agency companies as NRSROs, etc.), changes in the various credit rating structures or even changes to the meaning of the ratings. These changes will make the proposed rules ineffective or useless. Therefore, the Commission should not include credit quality requirements in any standards it may adopt regarding utility investments in money pools. However, if the Commission does decide to include ratings requirements, it should modify the draft rule to mirror the requirements of the Investment Act.

4. CTC Initial Comments

CTC states that no CTC affiliates meet the stated criteria of having an A-1 or even an A-2 level of commercial paper ratings since no affiliates of CTC currently issues commercial paper. In addition, ignoring all other factors, financial institutions do not look favorably on providing high-grade committed facilities for the purpose of credit protection between affiliates. For CTC's parent company, Citizens, the costs of securing high grade committed facilities may be out of proportion to any benefit provided by supplementing the credit facility given the large number of Citizens' affiliates operating in multiple jurisdictions.

Furthermore, regarding Section 340.30(b)(3), affiliates can borrow from the regulated utility if the affiliate is a "High Grade Credit Issuer." CTC informs us that Citizens has current long-term credit ratings of BBB/Baa2/BBB from Standards & Poor's, Moody's Investors Service, and Fitch Ratings. These ratings are "investment grade" ratings from all three credit agencies and indicate that the agencies believe Citizens has a good and adequate ability to repay its debt obligations. However, under Staff's Proposed Rules, Citizens would not satisfy the requirements of Section 340.30(b)(3) and therefore could not borrow from CTC. If the rules proposed by Staff were applied in all jurisdictions, the rules could create a liquidity crisis for Citizens and its affiliates, including CTC, due to limitations in the Proposed Rules regarding the movement of funds between affiliates. CTC argues that this is the very circumstance the Commission is trying to avoid.

CTC argues, Staff's Proposed Rule Section 340.40(b)(4) and (b)(5), should follow the long-term debt credit rating thresholds recommended for 340.40(b)(3).

In addition, CTC maintains, the money pool rules must accommodate the complex set of facts faced by each utility and regulated telecommunications carrier operating in the state including: organizational structure, capital structure, the capital markets in general, rating agencies, and investors (including state pension funds, company retirement plans and individual investors). The circumstances of each utility and telecommunications carrier are unique and an intractable set of rules constructed for the single organizational or operational model may very well have the unintended impact of adversely impacting Illinois consumers.

The existing practice for most utilities and regulated carriers in Illinois has been to file and obtain approval of affiliated interest agreements containing the terms and conditions associated with affiliate money pool or financing arrangements. This process has enabled the Commission to review and consider the fact-specific financing arrangements proposed by each company based on the company's unique organizational and capital structure. Given the complex set of facts faced by companies operating in Illinois, the Commission should not, CTC argues, attempt to rely upon one-size fits all rules regarding money pool arrangements for all utilities and incumbent local exchange carriers in Illinois.

CTC proposes that if a utility and affiliate do not meet the specific requirements proposed by Staff in Section 340.40(b)(1) through (6), the utility and affiliate should be able to make a filing and otherwise provide information to the Commission that will satisfy the Commission that the utility/affiliate transaction does not create a risk for consumers. Instead of relying almost exclusively on credit rating agencies, as proposed in Staff's Proposed Rules, the money pool rules should explicitly allow the utility to make this showing without the uncertainty and burdens of seeking a waiver of the Commission's money pool rules.

5. Staff Rebuttal Comments

Staff argues that Ameren's argument is contradictory, since Ameren depicts the committed credit facilities as low-risk yet increasingly difficult to obtain from banks. Liquidity backup mitigates liquidity risk. Staff asserts that the proposed rule requires 100% backup for utility money lent to affiliates that do not have high-grade commercial paper ratings to provide a high degree of assurance that a borrower would be able to repay the funds borrowed from the utility when needed. Furthermore, Staff argues, no utility, including Ameren, has indicated how entities that borrow from public utilities would repay their debt obligations on demand without committed credit facilities.

Staff argues that there are two critical differences between mutual funds and money pool agreements that support a higher credit quality requirement for money pool agreements. First, mutual funds are more diversified than money pool agreements. Second, there is a ready market for mutual fund securities should a mutual fund need cash. Moreover, SEC Rule 2a- 7(c)(3)(ii) limits a money fund's holdings of tier-2 securities (A-2/P-2/F-2) to no more than 5% of the funds assets.

Staff argues that a service company should only be allowed to borrow from a utility when it meets one of the criteria outlined in Section 340.40(b). Exempting service companies from the criteria outlined in Section 340.40(b) would undermine the objectives of the proposed rule by eliminating the safeguards intended to protect the utility's financial condition.

As an entity guarantees more obligations, Staff notes that an entity with an "A-" long-term credit rating rarely has an "A-1" short-term credit rating. Thus, guarantees for utility funds should be limited to entities with A-1/P-1/F-1 commercial paper ratings or high-grade committed credit facilities.

6. CTC Rebuttal Comments

Section 340.40(b) of Staff's Proposed Rules only identifies three situations and types of transactions under which an Illinois utility may lend funds to an affiliate. With respect to these three alternatives, each of Staff's proposed requirements rely exclusively on credit agency ratings as the threshold criteria for determining whether an affiliate transaction is acceptable. CTC recommends that if a utility and affiliate do not meet the specific requirements proposed by Staff in Section 340.40(b), the utility and affiliate should be able to make a filing with the Commission and otherwise provide information to the Commission that will satisfy the Commission that the utility/affiliate transaction does not create a risk for consumers.

CTC recommends the following provision be added to Section 340.40(b):

> (b) An affiliate shall be eligible for borrowing from the utility if the affiliate meets one of the following requirements: The Commission determines that the affiliate has adequate credit capacity or is otherwise financially capable of repaying a loan from the utility notwithstanding the inability to satisfy subsections 1) through 6) above.

CTC contends that Staff's Rebuttal Comments erroneously presume that its three isolated mechanisms of High Grade commercial paper ratings, High Grade Committed Credit Facilities, and High Grade Issuer credit ratings are the only means to demonstrate liquidity and ensure the repayment of an affiliate loan. Myriad other financing options, including granting of a security interest on assets (such as receivables), or long- and short-term multi-party financing arrangements may be viable and preferable options to Staff's "one-size-fits-all" rule. CTC's position is that the money pool rules should explicitly allow the utility to make this showing without the uncertainty and burdens of seeking a waiver of the Commission's money pool rules. The Commission's money pool rules should give the Commission the flexibility to respond to unique organization and capital financing structure of Illinois utilities in approving money pool arrangements and to determine whether other money pool arrangements are in the public interest.

7. Verizon Rebuttal Comments

Verizon pointed out in its reply comments that the Proposed Rule does not provide for unanticipated changes in credit agency criteria for maintaining credit ratings, restructuring of the credit agency industry changes in the various credit rating structures, or changes to the meaning of credit ratings. Verizon Initial Comments at 4-5. Changes to any of these factors would make the Proposed Rule ineffective or useless, Verizon contends.

Although some simple editing can resolve this issue, Verizon nevertheless argues that any rule ordered in this proceeding will be short-lived, as it cannot be constructed in a manner that can anticipate and capture the many future events that will void its effectiveness or usefulness. Consequently, the resulting rule will require many future revisions. Verizon therefore argues that considering that the effective MPA review process is already in place, new proceedings to modify the rule would be a waste of Commission and utility resources.

8. Ameren Rebuttal Comments

Ameren argues that the requirement of the Proposed Rule to provide duplicate backup lines of credit for the borrowing entity is excessive for purposes of an internal money pool. Though short-term borrowings via a commercial paper program do generally require backup liquidity facilities, other forms of short-term borrowing do not. An investment grade issuer will typically have ready access to direct short-term bank borrowings without the need for collateral or further backup liquidity.

Further, the bank market providing committed credit facilities is shrinking. The primary reasons for this are not related to credit quality as much as consolidations within the banking industry and that industry's heightened focus on returns on committed capital. Banks are increasingly hesitant to extend undrawn (backup) committed credit facilities because of the low profitability of this activity. Because of these factors, and not as a result of concerns with Ameren's financial condition, Ameren has had to forgo hundreds of millions of dollars of committed credit facilities over the past few years. The reason for the constriction of bank credit lines can be seen through an example: a common fee charged by banks for multi-year backup credit for an A-rated borrower is 12.5 basis points (0.125% per year on the unborrowed balance). On a facility of $100 million, the bank earns only $125,000 annually on this business. The bank, however, must reserve capital of $100 million to support this facility; capital that therefore is not available for the bank to use for other purposes. On the other hand, if the bank chose to employ that $100 million of capital to fund a $100 million LIB OR based loan to a similarly rated borrower, it would earn a return of about LIBOR plus 50 basis points (about 1.84% based on current rates). Thus, the loan would yield an annual return of $1.8 million, a much better return than the $125,000 for the committed credit that remains undrawn.

Furthermore, banks have increasingly been viewing the provision of committed credit as part of an overall relationship with borrowers. Part of that overall relationship includes services provided by the bank that do not require similar use of its capital such as cash management services, securities underwriting and investment management. A borrower such as Ameren can only offer a limited amount of such opportunities and thus the availability of committed credit lines is limited and such credit must be used in the most efficient manner possible.

9. UI Rebuttal Comments

UI is the parent company, and sole security holder, for 24 water and/or wastewater utility companies in Illinois ("UI Operating Companies"). While the UI Operating Companies serve a total of approximately 17,000 customers, many of the UI Operating Companies are very small. The largest company serves only 2,200 customers and about six of our UI Operating Companies serve less than 200 customers. UI can provide efficient and economical service to the customers of these small utilities only through the economies of scale brought about by our centralized operations.

UI has some serious concerns regarding how the proposed rule regarding money pools 83 Ill. Adm. Code § 340, if adopted, will impact the UI Operating Companies. UI has a highly centralized cash management function that is essential in order for it to obtain efficiencies and economies of scale to provide service in Illinois at reasonable rates.

Customer bill payments are received in numerous locations across the country, including Northbrook, Illinois (for UI's Indiana, Ohio and Illinois companies). These payments are applied to the customers' accounts and the revenues are booked directly to the respective company. For the Illinois cost center, the batches are deposited directly into a Bank One Depository Account on a daily basis. The Depository Account is in the name of Water Service Corp (WSC), UI's service company. The agreement by which WSC provides services to the UI Operating Companies has been approved by the Commission. None of the Illinois UI Operating Companies maintain any bank accounts and none of them directly pay any vendors, suppliers or employees. None of the Illinois UI Operating Companies have any borrowings from third parties. All system financing is done by UI.

UI's principal and interest payments and WSC's expenses and capital expenditures (which are all made on behalf of the various UI Operating Companies) are paid directly from the main Bank One Depository Account. By accounting entries determined by the allocation factors approved by the Commission, such expenses are allocated to the individual UI Operating Companies. The Commission should be very familiar with UI's system as a result of several rate cases we have conducted in the past several years.

Under the Proposed Rules, the cash management program of UI described above could be considered to give rise to "loans" from the UI Operating Companies to WSC and/or loans from WSC to the Operating Utilities. Because of the integrated nature of the system used by UI, it would be extremely difficult and expensive to track such "deemed" loans and otherwise comply with the Proposed Rule as currently drafted.

UI has sound credit but does not maintain public securities ratings from any of the three nationally recognized rating agencies. UI accesses the long-term debt markets through private placements to insurance companies and other institutional lenders.

All of UI's common stock is owned by Nuon NV, a public company located in the Netherlands. Nuon has a unsecured long-term debt rating of Aa3 (on watch for possible downgrade) and a P-1 short-term rating from Moody's. Nuon does not have ratings from any other nationally recognized rating agency.

UI states that Nuon may be willing to provide an unconditional guaranty of WSC's obligations to the UI Operating Companies. However, as noted, Nuon only has a single rating which would not qualify it as a guarantor under the Proposed Rule. Furthermore, UI would need relief from the other requirements of the Proposed Rule. UI would like to discuss with Staff possible alternative means of insuring the safety of the Illinois UI Operating Companies' funds.

UI suggests the following changes to the Proposed Rule:

1. Amend definition of "Service Company" in Section 340.20 as follows:

   "Service Company" means a mutual or subsidiary service company approved by the Securities and Exchange Commission pursuant to 17 CFR 250.88 or a service company providing services to utilities pursuant to a service agreement that has been approved by the Commission under Section 7-101 and/or 7-102 [220 ILCS 5/7-101 and/or 5/7-102] of the Act.

2. Add to Section 340.20 a new definition, as follows:

   "Water Utility" means any person that is a public utility solely by reason of owning facilities for the production, storage, transmission, sale, delivery or furnishing of water and/or the disposal of sewerage within the meaning of Section 3-105 [220 ILCS 5/3-105] of the Act.

3. Add to Section 340.10 (b) a new sub-item [5]):

5) A Water Utility that is an Affiliate of three or more other Water Utilities in the State and that uses a Service Company for purposes of aggregating customer receipts and paying all such Water Utility's vendors and other operating requirements is not subject to the requirements of Sections 340.30 and 340.40; provided that, to be eligible for this subsection (5), such Water Utility (i) may not issue indebtedness to any unaffiliated third party, (ii) must use the Service Company to conduct all of its cash flow operations [(iii) must be the beneficiary of a guaranty provided by a [High-grade credit issuer] of its Service Company's obligations to such Water Utility or such Service Company must have a [High-grade committed credit facility] that satisfies Section 340.40(b)(2)] and (iv) must have demonstrated to the satisfaction of the Commission (in a proceeding approving such affiliated interest transactions under Sections 7- 101 or 7-102 [220 ILCS 5/7-101 and/or 5/7-102] of the Act or otherwise) that in lieu of interest payments or credits from the Service Company to the Water Utility for funds used or charges by the Service Company to the Water Utility for funds advanced, the overall cost of providing services to such Water Utility by the Service Company appropriately allocates to such Water Utility the costs, savings and efficiencies of such cash flow system.

4. Add to Section 340.60 a new sub-item (f): 4

(f) A Water Utility that satisfies the requirements of Section 340.10 (b)([5]) and that is not subject to Section 340.60(b) shall provide, at the times reports would otherwise be required under Section 340.60(b), aggregate information for all such affiliated Illinois Water Utilities describing the net amount deemed to be owed by or owed to such Water Utilities from their affiliated Service Company at the end of each quarter taking into account all payments made or accrued by such Service Company on behalf of such Water Utilities.

UI has reviewed the background of the Proposed Rule and understands that the Staff has been flexible in addressing particular problems of certain Illinois utilities and note that the text of the Proposed Rule has been modified, consistent with the

Commission's overall goal of ensuring the safety of utilities' money, to accommodate the different practices of Illinois utilities. UI understands that it is bringing up concerns late in the process, but believe it has very legitimate issues. To fully comply with the Proposed Rule as currently drafted would likely require the addition of several new staff members, the cost of which would have to be borne by the customers of the Illinois UI Operating Companies. Further, depending on how the Proposed Rule is interpreted in light of UI's operations, it could be possible that UI would have to significantly modify its operating procedures that have been in place for many years, have been subject to numerous reviews by the Commission and have not led to any of the problems the Commission is seeking to address in the Proposed Rule.

10. Staff Surrebuttal Comments

Staff recognizes that regulatory oversight provides a higher degree of safety for utility funds in comparison to unregulated entities. Staff revised its proposed rule to allow short-term loans from utilities to affiliates that are also utilities as defined in Section 340.20. Attachment 1 to Staff's Surrebuttal Comments reflects this revision to the proposed rule.

Although Staff does not agree with the details of UI's proposed revisions to the rule, UI's Rebuttal Comments indicate that affiliates should be eligible to borrow from certain utilities if that affiliate provides cash management services to a utility that would be unable to efficiently raise debt capital on a standalone basis. Specifically, Staff recommends adding the following paragraph to Section 340.40(b):

> (7) The affiliate provides the utility cash management services through a Commission-approved agreement and the utility does not issue bonds, notes or other forms of indebtedness to persons or entities that are not affiliates of the utility and:
>
> A) The affiliate is a small utility; or
>
> B) The utility demonstrates that the benefits from relying on an affiliate to provide all the utility's capital exceed the risks associated with a decrease in the utility's financial independence provided that the affiliate is a medium-grade credit issuer.

Staff recommends two alternative paths for obtaining the above-proposed exemption depending on the size of the utility for the following reasons. First, the smallest utilities would benefit most from a centralized treasury function. Banks are typically the only source of capital for small utilities that raise their own capital. Bank debt is relatively costly and usually imposes terms and conditions that make it difficult for a company to maintain an appropriate capital structure.

In Section 340.20, Staff defines small utilities as those utilities with total capitalization of less than $50,000,000 and large utilities as those utilities with total capitalization equaling or exceeding $50,000,000. $50,000,000 represents the midpoint total capitalization of (1) utilities that have previously or would be able to issue debt and remain viable operating utilities and (2) utilities that have relied on bank loans for financing operations. Staff's review of Illinois utilities reveals that a substantial gap exists between the total capitalization of companies that rely on bank debt and those that do not rely on bank debt. Consumers Illinois Water Company, with a December 31, 2001, capitalization totaling $94,396,040, is the smallest Illinois utility that could likely issue non-bank indebtedness. In comparison, Mt. Carmel, with a December 31, 2001, capitalization totaling $10,231,287, is the largest Illinois company that has been limited to bank loan financing. Using the midpoint of those companies' total capitalization as a starting point, i.e., $52, 313, 664, Staff recommends using $50,000,000, to define the dividing line between a small utility versus a large utility for the purpose of the proposed rule.

Staff's revision to Section 340.40(b) would designate an affiliate as an Eligible Borrower from a large utility provided: (1) the affiliate provides utility cash management services through a Commission-approved agreement; (2) the utility does not issue indebtedness to non-affiliates; and (3) the utility demonstrates to the Commission that the benefits resulting from its reliance on an affiliate to raise its capital exceed the risks resulting from its lower degree of financial independence provided the affiliate is a medium-grade credit issuer as defined in Section 340.20. For the purpose of this exemption, a lower credit quality standard than otherwise required in Section 340.40 is acceptable. That is, the utility's burden pursuant to Section 340.40(b)(7)(B) is such that a minimum degree of assurance of repayment for utility funds must exist; otherwise, it would be impossible to demonstrate that risks resulting from an affiliate raising all of a utility's capital is offset by the benefits resulting from such an arrangement.

Staff opposes CTC's proposal. Granting a security interest on assets such as receivables results in utilities exchanging cash for less liquid assets. CTC's proposal exposes utilities to the uncertainty of if and when customers pay the amounts due to the utility's affiliate. Moreover, CTC's proposal would expose utilities to the risk inherent in affiliates' businesses.

Staff asserts that CTC's reference to long- and short-term multi-party financing arrangements is too vague to be a reasonable alternative for the purpose of the proposed rule. Currently, Section 340.40(b)(2) of the proposed rule allows an affiliate to borrow from a utility if the aggregate amount of outstanding short-term debt of the affiliate, includes amounts to be borrowed from the utility, excluding amounts drawn on the committed credit facility, does not exceed the unused balance of funds available to the affiliate under high-grade committed credit facilities at any time, plus the amount of funds the affiliate invests in interest-bearing bank accounts and U.S. Treasury securities. The proposed rule allows interest bearing bank accounts and U.S. Treasury securities as collateral for short-term loans since they are safe and highly liquid investments, unlike receivables. CTC has had two opportunities to make proposals for specific alternatives but has failed to do so. CTC's proposal should be rejected.

11. Commission Review and Conclusion

The Commission's objectives for money pool rules are contradictory to expanding Section 340.40. In fact, Section 340.40 should be the most narrowly tailored part of the New Rules to fully protect Illinois utilities. However, it has been the most hotly contested section of the New Rule. Nevertheless, it is the Commissions obligation to balance the risk and benefit to the utility and its affiliates in the money pool. To that end, the Commission adopts Staff's proposed changes in its Surrebuttal Comments. Namely, the allowance of an affiliate utility to borrow from a utility, and an affiliate that provides cash management services as described in the attached Appendix to borrow from the utility.

The Commission does not agree that the "high-grade credit" standard should be lowered, utilities should be allowed to loan funds to their parent companies, centralized treasury function alleviate credit risk, or a waiver provision should be adopted. None of these proposals would benefit the public interest or benefit the utilities. Their sole benefit seems to be for the affiliates and parent companies. The Commission is under the impression that the variety of options is enough.

B. Section 340.40(d)

1. Staff Initial Comments

Supra at E(1)(a)

2. ComEd Initial Comments

ComEd believes that the portion of the Proposed Rule regarding the rate of return required in order for a utility to lend money to an affiliate should be amended. The Proposed Rule currently provides, in this regard, that:

> d) The Utility shall not lend funds to an affiliate if the utility can earn a higher rate of return on investment of similar risk in the open market.

ComEd contends that this rule would be difficult to apply in practice. First, this requirement assumes that "investments of similar risk in the open market" can be readily identified. It is not likely that this would be the case, and thus the rule could lead to prolonged debates about largely subjective measures of risk. The difficulty of applying the proposed rule is also a reflection, in part, of the fact that most if not all utilities generally invest in vehicles such as money market funds, or via automatic investment sweeping arrangements with their banks, and not in individual companies. Therefore, the proposed rule is not consistent with the manner in which utilities generally invest.

ComEd believes that the policy the Staff seeks to further could more easily be achieved if the rule alternatively required that the utility receive from its affiliate a return no lower than it would have received on its existing investments. For all the above reasons, ComEd proposes that the language of proposed Section 340.40(d) should be amended to read as follows:

> d) The utility may lend funds to an affiliate only if (i) the utility cannot earn a higher rate of return on investments of similar risk in the open market, or (ii) the utility will earn no less than the rate the utility would have earned on investments in existing short-term investment accounts maintained by the utility the period in question.

ComEd believes that its proposed amendment would ensure that the utility receives nothing less when the utility lends funds to an affiliate than it otherwise would have received if the lent funds were invested in the utility's existing investment accounts, while making the requirements of the rule easier to apply and enforce.

3. Staff Rebuttal Comments

Staff contends that ComEd's proposal would still permit an affiliate to borrow at interest rates that are below interest rates that the affiliate would have to pay in the market. Consequently, Staff disagrees with ComEd's language proposal for Section 340.40(d) since this proposal could allow a utility to unjustly subsidize affiliates, which would violate one of the proposed rule's objective described on page 2 of Staff's Verified Initial Comments.

4. ComEd Rebuttal Comments

ComEd submits that the characterization Staff attaches to ComEd's proposal is unwarranted. ComEd argues that its proposal would not allow a utility to loan to an affiliate at an interest rate less than the utility could obtain from its current investments, so that the utility would be no worse off by loaning to an affiliate than if it did not do so. Moreover, ComEd contends, the affiliate would be better off because it could borrow from the utility at a rate lower than it would pay in the market. Thus, not only is the utility indifferent, but the affiliate is better off. ComEd believes that Staff objects because it views this result as a subsidy. ComEd disagrees that this result is a subsidy.

ComEd contends that Staff's objection must be based on the unsubstantiated belief that if the utility did not loan to the affiliate, the utility would achieve a higher return on an investment in the open market, *i.e.*, that the utility is foregoing a benefit in order to make a loan to an affiliate.

5. Staff Surrebuttal Comments

Staff considers ComEd's argument reasonable and withdraws its objection to ComEd's proposal. Staff's revised proposed rule, included as Attachment 1, includes ComEd's proposal.

6. Commission Review and Conclusion

The Commission agrees with both Staff and ComEd, and adopts Staff's revised language:

> (d) The Utility may lend funds to an affiliate only if the utility cannot earn a higher rate of return on investments of similar risk in the open market, or the utility will earn no less than the rate the utility would have earned on investments in existing short time investment accounts maintained by the utility during the period in question.

C. Section 340.40(h)

In its Brief on Exceptions, Staff pointed out an inconsistency in 340.40(b) and suggested adding a new section (h) to identify the filing requirements for a utility to use. The Commission agrees with the addition of the new subsection.

VII. SECTION 340.50: INVESTMENT OF SURPLUS FUNDS

A. Staff Initial Comments

Section 340.50 identifies the short-term investments allowable for money pool funds. Such investments include affiliates that meet the eligibility requirements of Section 340.40(d), interest-bearing accounts with banks, and various other financial instruments. These investments are relatively secure and liquid; hence the money pool funds will be safe and accessible when needed.

B. Nicor Initial Comments

Section 340.50(a) should be expanded to authorize the investment of money pool funds in repurchase agreements with financial institutions rated AA or above by Standards and Poor's or its successor, Aa or above by Moody's Investors Service or its successor, or AA or above by Fitch Ratings or its successor with a minimum of 102% over collateralization. Such repurchase agreements are at least as safe as, if not safer than, some of the short-term investment vehicles currently listed in Section 340.50(a) of the proposed money pool rule, because an investor in a repurchase agreement has two sources of repayment: 1) the investor can look to the financial institution for repayment; and 2) the investor can look to the underlying collateral for repayment.

C. CTC Initial Comments

Section 7-102(A)(h) states in pertinent part: "No public utility may, directly or indirectly, invest, loan or advance, or permit to be invested, loaned or advanced any of its moneys, property or other resources in, for, in behalf of or to any other person, firm, trust, group, association, company or corporation whatsoever," without Commission approval. Section 7-102 only applies to investments, loans or advances from the regulated utility to the affiliate. The repayment of a loan or payment of interest on a loan from the affiliate to the regulated utility is not within the scope of Section 7-102, and therefore should be exempted from the scope of the Proposed Rules regarding the investment or use of the utility's funds. CTC recommends that the following language be added to Section 340.50:

> c) This section does not apply to an incumbent local exchange carrier's repayment of a loan from an affiliate.

D. Staff Rebuttal Comments

First, Nicor proposes adding a clause to Section 340.50(a) that allows repurchase agreements with financial institutions rated AA or above by Standard & Poor's or its successor, Aa or above by Moody's Investors Service or its successor or AA or above by Fitch Ratings or its successor with a minimum of 102% over collateralization. Nicor Comments at 2-3. Staff does not object and has included Nicor's proposal as Section 340.50(a)(11) as shown on Attachment 1 of Staff's Rebuttal Comments.

Second, CTC proposes that Section 340.50(c) be added to provide an exemption to an incumbent local exchange carrier's repayment of a loan from an affiliate. CTC Initial Comments at 20. Staff never intended that Section 340.50 would restrict how a qualified borrower of a utility would use the loan proceeds. Rather, Section 340.50 is intended to restrict investment of surplus funds. Staff asserts that CTC's proposed exemption is unnecessary given that an affiliate meeting the requirements of Section 340.40(b) may use borrowed funds from the utility, as it deems appropriate. Staff revised Section 340.50(a) to clarify this position as shown on Attachment 1 of Staff's Rebuttal Comments.

E. Staff Surrebuttal Comments

Verizon proposes modifying Section 340.50 to reflect Verizon's position that investment-grade credit ratings are adequate to protect the public. Staff disagrees with Verizon's proposal for the reasons set forth in response to Verizon's same argument regarding Section 340.20.

F. Commission Review and Conclusion

The Commission agrees with Staff, and approves Nicor's proposal to add a clause to Section 340.50(a) that allows repurchase agreements with financial institutions rated AA or above by Standard & Poor's or its successor, Aa or above by Moody's Investors Service or its successor or AA or above by Fitch Ratings or its successor with a minimum of 102% over collateralization.

The Commission also does not intend to restrict how a qualified borrower of a utility would use the loan proceeds, and does not see it necessary to adopt CTC's proposed exemption. The Commission adopts Staff's revision for clarification.

The Commission agrees with Staff's position on investment-grade credit rating, and has already clarified its opinion on that point.

VIII. SECTION 340.60: REQUIRED FILINGS AND PROCEDURES

A. Staff Initial Comments

Section 340.60 specifies the required filings and procedures for utilities, including telecommunications carriers involved in money pool agreements. This Section would allow the Commission to monitor the transactions that transpire under the money pool agreements and further ensure compliance with the rules. The utility would be required to file quarterly reports documenting all daily deposits, borrowings, interest income, and interest expense relating to transactions with affiliates. The utility would also be required to report all affiliates that would participate in the money pool agreement and any credit rating downgrades to those affiliates. This Section also outlines the procedures required to obtain confidential treatment of filings made pursuant to this Section.

B. SBC Initial Comments

Section 340.60(c) requires that the utility file a "report listing all of the affiliates with which it can participate in the money pool agreement" and further requires that an update of the report be filed "within ten days after an affiliate is added to money pool agreement." SBC Illinois does not believe that it should be necessary to update the report required by Section 340.60(c) within ten days after every addition of an affiliate to the money pooling arrangement. In this regard, SBC participates in a money pooling arrangement, which is administered by SBC Communications. While over 80 affiliates currently participate in the pool, all borrowing and lending transactions are between individual affiliates and the parent company, SBC Communications. There are no direct lending or borrowing arrangements among affiliates other than SBC Communications. Affiliates are frequently added to (and subtracted from) the pooling arrangement. These additions do not, however, have any direct impact on SBC.

Accordingly, a requirement that the list of affiliates be updated every time an affiliate that does not have a direct borrowing relationship with the utility is added to the money pooling arrangement is unnecessary. For this reason, SBC proposes that the second sentence of Section 340.60(c) be revised to state as follows:

> (c) An update of the report shall be filed within ten days after an affiliate which has a direct borrowing relationship with the utility is added to the money pool arrangement.

To the extent that the Commission deems it necessary to monitor additions of other affiliates to the money pooling arrangement, SBC suggests that Section 340.60(b)(2) be revised to include, as part of the quarterly reports required under that section, updates to the list of affiliate participants in the pool. Quarterly reporting of any changes to the affiliates participating in the pool should be sufficient for monitoring purposes and would eliminate the need for additional filings between the quarterly reports.

Section 340.60(d) of the Proposed Rule requires that "any credit rating downgrades to any affiliate that is eligible for borrowing from a utility by a credit rating agency be reported to the utility and the Manager of the Commission's Finance Department." For the same reasons as those discussed above with respect to Section 340.60(c), SBC proposes that this section be revised to impose the ten day reporting requirement only for downgrades of the credit rating of any affiliate holding a direct borrowing relations hip with the utility. Furthermore, this reporting requirement should only be required for downgrades that result in a credit rating below "high grade" (defined in the Proposed Rules as A-/A3 or above). Other changes in credit ratings can be monitored on a quarterly basis as part of the reports required under Section 340.60(b)(2). Accordingly, SBC proposes that the first sentence of Section 340.60(d) be revised to read as follows:

> (d) Any credit rating downgrades to any affiliate that has a direct borrowing relationship with the utility by a credit ratings agency which results in a credit rating for such affiliate of less that High Grade (i.e., A-/A3 or above) shall be reported to the utility and the Manager of the Commission's Finance Department within ten days after any such downgrade.

C. CTC Initial Comments

CTC contends that the level of detailed reporting requested by Staff in the proposed Section 340.60(b) goes beyond the reporting capability of Citizens' current financial systems which have been designed to provide monthly reporting. Citizens' financial system does not calculate a loan balance for each company affiliate on a daily basis. Citizens' operating entities utilize a centralized cash concentration and disbursement system that aggregates detailed transactions into the end of the-month financial statements. Assuming a borrowing activity and loan activity associated with cash sweeps and disbursements for each of the approximately 60 business days in a calendar quarter, the level of detail proposed to be reported for a single company would reach 120 daily loan balance increase and loan balance decrease reports under Staff's Proposed Rules. For a company of the size and complexity of Citizens with potentially 50 operating telecommunications affiliates could potentially include 3000 borrowing and loan transactions on a quarterly basis. CTC contends that it is unclear what if any value this level of detailed daily information would provide to the Commission, or that the benefits of the Commission receiving this information would outweigh the significant administrative burdens of reporting this copious detailed information for both loan balance increases and loan balance repayments which are not available from Citizens' financial systems.

Instead of the required filing of detailed daily transaction documentation, CTC recommends that regulated utilities and telecommunications carriers should only be required to include month end balance information in their quarterly report. The preparation of month end statement is consistent with CTC' general accounting practice of closing its financial books on a monthly basis. CTC does not close its books on a daily basis and its financial systems does not have the capability to report daily balances as contemplated by the Staff's Proposed Rules.

CTC recommends that with respect to additional detail regarding loan balances, the utility should merely be required to maintain records of all transactions for one year to ensure compliance with the applicable rules and/or the requirements contained in their company-specific money pool agreement approved by the Commission. To the extent the Commission believes it needs to review detailed transaction information, the Commission's Staff can request this information from the specific companies. CTC recommends the following changes to Section 340.60(b):

CTC contends that Staff has indirectly and in effect included a "debt rating trigger" in the Proposed Rules Section 340.60(d) that provides:

> d) Any credit rating downgrades to any affiliate that is eligible for borrowing from the utility by a credit ratings agency shall be reported to the utility and the Manager of the Commission's Finance Department within ten days after any such downgrade. Each filing shall state on its face the Docket number of the proceeding authorizing the utility's participation in the money pool agreement.

CTC argues that with this language a utility would be required to report to the Commission a situation in which one of its affiliates' debt rating was downgraded. Staff's comments contain no explanation why this information must be filed or how it would be used. It is also not clear why this information must be filed for an affiliate that previously had not actually borrowed any funds from the money pool or the regulated utility.

In addition, CTC notes there is no discussion in the Staff's Comments or the proposed rule regarding what effect the debt rating slippage would have on a utility. Presumably Staff would use the information required in Section 340.60(d) to monitor compliance with the credit threshold requirements contained in the Proposed Rules. Staff would presumably then assess whether a violation of the standards has occurred because an affiliate participating the in money pool does not meet the credit agency rating threshold requirements contained in the rules.

Any interpretation of the Proposed Rules that would require an affiliate to repatriate cash to a regulated utility or telecommunications carrier due to the loss of a specific credit rating would create a liquidity trigger that is a primary concern of rating agencies and investors. The mere presence of such a trigger would potentially lead to reductions in credit ratings and the financial health of the affected utilities. In addition, the introduction of liquidity triggers in Illinois is likely to induce other jurisdictions to create either similar triggers or to prevent the outflow of capital from their jurisdictions, which was previously provided to Illinois utilities. The consequence of a recall of funds advanced to Illinois utilities from utilities in other jurisdictions would clearly be to the detriment of operations and capital spending programs in the State of Illinois.

CTC recommends that if a credit downgrade occurs for an affiliate that has actually borrowed from the utility, the utility should be allowed thirty days to report this downgrade to the Commission. This downgrade could then prompt a Commission investigation to evaluate the financial condition of the affiliate and determine what, if any, steps the utility is required to take. However, it should be clear that a debt rating downgrade by one or more rating agencies, which may be based on economic, competitive and other conditions completely beyond the control of the regulated utility, should not be considered to trigger a violation of the Commission's money pool agreement rules and should not necessitate an immediate repatriation of funds from the downgraded affiliate.

To address these concerns, CTC recommends that Section 340.60(d) be revised as follows:

> d) Any credit rating downgrades to any affiliate that has borrowed from the utility by a credit ratings agency shall be reported to the utility and the Manager of the Commission's Finance Department within ten thirty days after any such downgrade. Each filing shall state on its face the Docket number of the proceeding authorizing the utility's participation in the money pool agreement. Absent further investigation and an order from the Commission, the credit rating agency downgrade will not be deemed a violation of these rules or trigger any requirement to restructure the loan from the utility to the affiliate.

D. Verizon Initial Comments

Verizon contends that in the past, the Commission did not require additional reporting requirements regarding the operation of money pools in its approval because it could already monitor utility short-term debt and investment balances from balance sheets included in existing monitoring reports. Verizon believes that more reporting was not needed then and it is not needed now. It is Verizon's opinion that the detailed reporting requirements included in the proposed rule add nothing to further the objective of such proposed reporting. They will provide no insight into the ability of the utility to repay its obligations or the safety of its investments in the money pool. They are simply more regulatory "noise" that increases the burden on utilities, and the Commission, but accomplish little else.

In spite of this, if the Commission deems it necessary to order reporting requirements, Verizon suggests that the notification of new participants in the money pool (*See* Section 340.60 (c)) and credit rating downgrades (*See* Section 340.60 (d)) be incorporated into the quarterly report rather than remain as separate reporting requirements. Verizon maintains that there is no reason that the Commission be notified of these changes within ten days of occurrence.

E. Staff Rebuttal Comments

First, SBC's Comments indicate that SBC interprets the Section 340.60 provisions as applying to an incumbent local exchange carrier only if the incumbent local exchange carrier engages in lending transactions subject to Section 340.40 of the proposed rule. SBC Initial Comments at 2. Staff agrees with SBC's interpretation of Section 340.60. Incumbent local exchange carriers do not need Commission approval to borrow from affiliates. 220 ILCS 5/13-601. Therefore, such carriers would not be subject to Sections 340.30 and 340.60(b)(1).

Secondly, CTC, SBC and Verizon propose changes to Section 340.60 that reduce the filing and procedure requirements for utilities involved in money pool agreements. CTC argues that the level of reporting required by Section 340.60(b) is beyond the reporting capability of Citizen's current financial systems. CTC Initial Comments at 20. CTC proposes Section 340.60(b) require public utilities' quarterly reports include month end balance information rather than daily balances. The inability of CTC's financial system to report daily balances is worrisome. Public utilities that lend surplus funds to affiliates should have the financial capability to track the amounts lent on a daily basis. Staff strongly opposes CTC's proposal because a public utility that participates in a money pool agreement but maintains inadequate financial records cannot even be sure that it has not inadvertently lent its funds without Commission authority pursuant to Section 7-102 of the Act. Furthermore, inadequate record management makes it difficult, if not impossible for management to detect an erosion of financial condition on a timely basis.

Thirdly, Staff also opposes CTC's proposal to modify Section 340.60(d) so that a debt rating downgrade by one or more credit rating agencies would not necessitate immediate repayment of funds from the downgraded affiliate. CTC Initial Comments at 25. Should a credit ratings agency downgrade below high-grade a money pool participant that borrows from a public utility under the Section 340.40(b), it would violate the proposed rule. Credit ratings are a tool for evaluating an entity's financial strength. CTC's proposed rule change would be ineffective in protecting utility money deposited with or loaned, advanced or temporarily transferred to affiliates.

Fourthly, according to SBC, it is unnecessary to update the report required by Section 340.60(c) within ten days after adding an affiliate to the money pooling agreement. SBC suggests that the Section 340.60(c) report be limited to affiliates with a direct borrowing relationship with the utility. To the extent the Commission deems it necessary to monitor additions of other affiliates to the money pool agreement, SBC suggests that Section 340.60(b)(2) be revised to include updates to the list of affiliate participants in the money pool agreement as a part of the quarterly reports required under that section. SBC Initial Comments at 2.

Verizon also suggests that the notification of new participants in the money pool be incorporated into the quarterly reports. Verizon Initial Comments at 6. Staff does not object and has revised Section 340.60(c) to include this proposal as shown on Attachment 1 of Staff Rebuttal Comments.

SBC asserts that Section 340.60(d) be limited to affiliates holding a direct borrowing relationship with the utility. SBC Initial Comments at 2. Staff does not object and has included SBC's proposal in Section 340.60(d) as shown on Attachment 1 of Staff Rebuttal Comments.

Verizon suggests that the rules be modified to incorporate notification of credit rating downgrades into the quarterly report rather than a separate reporting requirement. Verizon Initial Comments at 6. SBC suggests that the ten-day reporting requirement in Section 340.60(d) be limited to downgrades that result in a credit rating below high-grade (defined in Section 340.20). Other changes in credit ratings can be monitored on a quarterly basis as part of the reports required under 340.60(b)(2). SBC Initial Comments at 3. Staff does not object to SBC's proposal and has revised Section 340.60(d) to include this proposal as shown on Attachment 1 of Staff Rebuttal Comments.

F. CTC Rebuttal Comments

CTC argues that neither Staff's initial nor rebuttal comments provide any explanation why daily reporting should be required on a regular basis instead of month-end reporting consistent with generally recognized financial reporting practices.

CTC further argues that Staff Rebuttal Comments regarding daily reporting obligations completely misread CTC's Initial Comments, which indicated that Citizens' current financial systems have been designed to provide monthly reporting and not to calculate and report an outstanding loan balance for each company affiliate on a daily basis. Contrary to Staff's representation, Citizens does maintain adequate financial records and does have adequate record management. The issue raised by Staff's proposed rule is "daily reporting" of all loan increase and repayment activity. CTC's systems is capable of generating a report showing the outstanding loan balance at the beginning of one calendar month, all transactions occurring during the month and the outstanding loan balance at the end of that month. At any particular point in time, CTC may manually calculate the daily loan balance which is the aggregate of the month-to-date centralized cash concentration and disbursement system, however, there is currently no reason or benefit associated with revising Citizens' financial reporting system to automatically generate daily reports to accomplish this calculation. A month-end report summarizes all of the monthly loan activity. It is unclear why a month-end report would not provide a sufficient level of detailed information to the Commission, especially since the data will not be submitted to the Commission until 30 days after the end of the calendar or fiscal quarter.

The reporting of daily loan activity is also inconsistent with general industry reporting practices. When public companies report to lenders, the companies generally report on a quarterly basis and use quarter-end balances. As a general rule, the capital markets, including commercial paper markets upon which Staff heavily relies, are not concerned with day-to-day loan balances or activity and instead review end of the quarter data. Therefore, CTC's proposal to provide month-end results for each quarter already goes beyond industry-accepted financial reporting requirements accepted by the capital markets.

CTC contends that Staff has not identified any additional benefits associated with the Commission receiving daily transaction information or even committed that Staff would regularly review the gargantuan reams of data that the dozens of Illinois utilities will provide. Instead of the required filing of detailed daily transaction documentation, regulated utilities and telecommunications carriers should only be required to include month end balance information in their quarterly report. CTC believes that to the extent the Commission believes it needs and specific situations warrant the review of daily detailed transaction information, the Commission's Staff can request this information from the specific companies.

CTC-Illinois has recommended that Section 340.60(d) be revised to add the following two sentences at the end of the provision:

> Absent further investigation and an order from the Commission, the credit rating agency downgrade will not be deemed a violation of these rules or trigger any requirement to restructure the loan from the utility to the affiliate.

Under Staff's approach, it would be irrelevant as to why the credit agency downgrade occurred, including whether the downgrade is based on economic, competitive and other conditions completely beyond the control of the regulated utility and its affiliate. Staff has provided no explanation why a debt rating downgrade by one or more rating agencies should automatically trigger a violation of the Commission's money pool agreement rules and should require an immediate repatriation of funds from the downgraded affiliate. The proposed rule would put an affiliate and/or Illinois utility, that may already be in a precarious financial condition as a result of a credit rating downgrade, in the position of deciding whether it must violate the Commission's rule and seek a waiver or repay the borrowed funds and further jeopardize its financial condition. Staff's Rebuttal Comments make it clear that Staff is seeking to create rules that would remove all discretion and public interest considerations by the Commission and instead require an affiliate to follow Staff's rationale and repay all outstanding loans if the affiliate's credit rating was adjusted down below High Grade by even one of the three rating agencies. Instead of automatic repayment requirements resulting from a credit downgrade, the downgrade could prompt a Commission investigation to evaluate the financial condition of the affiliate and determine what, if any, steps the utility is required to take.

G. Staff Surrebuttal Comments

With respect to Staff's Section 340.40(b)(7) provision, Staff has added a new provision under Section 340.60(a) that clarifies Section 340.60 does not apply to small utilities as defined in Section 340.20. Accordingly, Staff modified the remaining Section 340.60 subsection headings to reflect the new Section 340.60(a) provision.

Staff argues that Section 340.60 reporting requirements are necessary given the Commission does not have access to the same level of information that a utility has. Staff's recommended reporting requirements require only a fraction of the data that a well-informed cash manager would need to be knowledgeable of cash flows throughout a company. For example, Staff's proposal does not include daily cash deposits and disbursements of affiliates that do not involve loans to and from utilities. Furthermore, CTC's proposal would give utilities an opportunity to bury excessive loans to affiliates. That is, in a given month, a utility could lend to its affiliates an amount that exceeds the amount allowed under the proposed rule under the assumption that the utility will be repaid by the end of the month. Enron expected it could repay its pipeline affiliates short-term loans, but Enron was wrong. A utility could make the same mistake as Enron. CTC's proposal is particularly troubling since it is unclear how CTC would know that it was exceeding loan limits given that it does not track the day-to-day cash position of CTC. Finally, the quantity of data that Staff seeks pursuant to Section 340.60 is not as large as CTC claims. A quarter comprises 13 weeks; given that there are 5 business days in a week, the report need not exceed 65 rows of data per utility. Staff is fully prepared to review reports of this magnitude.

Staff also argues that Section 340.60 is designed to ensure compliance with the proposed rule by allowing Staff to monitor transactions between utilities and affiliates pursuant to Commission-approved money pool agreements. The task of monitoring transactions is not designed to immediately reverse transactions in which utilities and affiliates do not adhere to the rule. Rather, it allows Staff to check on utility compliance after the fact, thereby, reducing the incentive to "cheat" and promoting future compliance with the rule.

CTC proposes modifying Section 340.60(d) to add the following two sentences at the end of the provision:

> Absent further investigation and an order from the Commission, the credit rating agency downgrade will not be deemed a violation of these rules or trigger any requirement to restructure the loan from the utility to the affiliate. CTC Rebuttal Comments at 17.

Staff agrees that borrowers should be granted a grace period to repay outstanding loans or time to get back into compliance with the rule. Staff recommends that if an affiliate borrower is no longer in compliance with the Section 340.40 requirements (i.e., the borrower is downgraded below the credit ratings thresholds established in Sections 340.20 and 340.40 or the affiliate borrower does not have sufficient back up liquidity sources as required by Section 340.40) at the same time it has outstanding short-term balances due to the utility, then the proposed rule should prohibit the utility from lending additional funds to the downgraded affiliate until the affiliate is again in compliance with the proposed rule. Furthermore, the rule would allow the affiliate 90 days from the day the credit rating downgrade occurs to comply with the proposed rule. However, Staff believes this language is more suitable for Section 340.40 rather than Section 340.60. Specifically, Section 340.40(g) provides: A utility shall neither lend additional funds nor extend the term of existing loans to any affiliate that no longer meets any of the eligibility criteria of subsection (b) [of Section 340.40]. An affiliate that exceeds its borrowing limit shall have 90 days to repay sufficient principal and accrued interest to bring that affiliate back into compliance with subsection (b) or, alternatively, to repay all outstanding loans from the utility and accrued interest.

H. Commission Review and Conclusion

The Commission agrees with Staff that daily reporting is neither burdensome to the utility nor to Staff. The daily reporting is essential to keep Staff up to date and aware of any money pool transactions concerning an Illinois utility. This monitoring would also expect a level of integrity in the utility's books.

In accord with Staff, the Commission too is troubled that CTC must manually determine if it is over any borrowing limits, and feels that daily reporting to the Commission would alleviate this potential problem.

The Commission finds Staff's proposed language to Section 340.40(g) a good compromise. The purpose of this Order is to ensure the financial security of utilities in regard to money pool agreements. The Commission agrees with CTC that a trigger could be detrimental to the credit rating of an Illinois utility or affiliate and will adopt Staff's proposed language.

IX. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

(1) the Commission has jurisdiction over the parties and the subject matter;

(2) the recitals of fact set forth in prefatory portion of this Order are supported by the record and are adopted as findings of fact;

(3) the proposed rule of 83 Ill. Adm. Code 340, as reflected in the attached Appendix, should be submitted to the Secretary of State pursuant to Section 5-40 of the Administrative Procedure Act.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the proposed rule 83 Ill. Adm. Code 340, as reflected in the attached Appendix, be submitted to the Secretary of State pursuant to Section 5-40 of the Administrative Procedure Act.

IT IS FURTHER ORDERED that this Order is not final; it is not subject to the Administrative Review Law.

By order of the Commission this 25th day of November, 2003.

(SIGNED) EDWARD C. HURLEY

Chairman